Internal Revenue
bulletin

Bulletin No. 1998–20
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HIGHLIGHTS OF THIS ISSUE

These synopses are intended only as aids to the reader in identifying the subject matter covered. They may not be relied upon as authoritative interpretations.

INCOME TAX

REG–251698–96, page 14.
Proposed regulations under sections 1361 and 1362 of the Code interpret the rules permitting an S corporation to own 80 percent or more of the stock of a C corporation, and to elect to treat a wholly owned subsidiary as a qualified subchapter S subsidiary (QSSS).

Announcement 98–39, page 24.
This announcement contains corrections to final regulations T.D. 8765 (1998–16 I.R.B. 11) relating to adjustments required when a qualified business unit (QBU) that used the profit and loss method of accounting (P&L) in a post-1986 year begins to use the dollar approximate separate transaction method of accounting (DASTM) and adjustments required when a QBU that used DASTM begins using P&L.

EMPLOYEE PLANS

T.D. 8768, page 4.
Final and temporary regulations under section 417(e) of the Code provide guidance to employers in determining the present value of an employee's benefit under a qualified defined benefit pension plan, for purposes of the applicable consent rules and for determining the amount of a distribution made in any form other than certain nondecreasing annuity forms.

EXEMPT ORGANIZATIONS

REG–121268–97, page 12.
Proposed regulations under section 513 of the Code clarify when the travel and tour activities of tax exempt organizations are substantially related to the purposes for which exemption was granted.

Announcement 98–41, page 25.
A list is given of organizations now classified as private foundations.

ADMINISTRATIVE

Announcement 98–40, page 24.
This announcement contains corrections to the notice of proposed rulemaking REG–208299–90 (1998–16 I.R.B. 26). The proposed rulemaking under sections 482 and 864 of the Code relates to the allocation among controlled taxpayers and sourcing of income, deductions, and gains and losses from a global dealing operation; rules applying these allocation and sourcing rules to foreign currency transactions and to foreign corporations engaged in a U.S. trade or business; and rules concerning the mark-to-market treatment resulting from hedging activities of a global dealing operation. The public hearing originally scheduled for July 9, 1998, has been rescheduled for July 14, 1998.

Finding Lists begin on page 31.
Announcement of the Consent Voluntary Suspension of Attorneys, Certified Public Accounts, Enrolled Agents, etc., begins on page 28.

Department of the Treasury
Internal Revenue Service

Mission of the Service

The purpose of the Internal Revenue Service is to collect the proper amount of tax revenue at the least cost; serve the public by continually improving the quality of our products and services; and perform in a manner warranting the highest degree of public confidence in our integrity, efficiency, and fairness.

Statement of Principles of Internal Revenue Tax Administration

The function of the Internal Revenue Service is to administer the Internal Revenue Code. Tax policy for raising revenue is determined by Congress.

With this in mind, it is the duty of the Service to carry out that policy by correctly applying the laws enacted by Congress; to determine the reasonable meaning of various Code provisions in light of the Congressional purpose in enacting them; and to perform this work in a fair and impartial manner, with neither a government nor a taxpayer point of view.

At the heart of administration is interpretation of the Code. It is the responsibility of each person in the Service, charged with the duty of interpreting the law, to try to find the true meaning of the statutory provision and not to adopt a strained construction in the belief that he or she is "protecting the revenue." The revenue is properly protected only when we ascertain and apply the true meaning of the statute.

The Service also has the responsibility of applying and administering the law in a reasonable, practical manner. Issues should only be raised by examining officers when they have merit, never arbitrarily or for trading purposes. At the same time, the examining officer should never hesitate to raise a meritorious issue. It is also important that care be exercised not to raise an issue or to ask a court to adopt a position inconsistent with an established Service position.

Administration should be both reasonable and vigorous. It should be conducted with as little delay as possible and with great courtesy and considerateness. It should never try to overreach, and should be reasonable within the bounds of law and sound administration. It should, however, be vigorous in requiring compliance with law and it should be relentless in its attack on unreal tax devices and fraud.

Introduction

The Internal Revenue Bulletin is the authoritative instrument of the Commissioner of Internal Revenue for announcing official rulings and procedures of the Internal Revenue Service and for publishing Treasury Decisions, Executive Orders, Tax Conventions, legislation, court decisions, and other items of general interest. It is published weekly and may be obtained from the Superintendent of Documents on a subscription basis. Bulletin contents of a permanent nature are consolidated semiannually into Cumulative Bulletins, which are sold on a single-copy basis.

It is the policy of the Service to publish in the Bulletin all substantive rulings necessary to promote a uniform application of the tax laws, including all rulings that supersede, revoke, modify, or amend any of those previously published in the Bulletin. All published rulings apply retroactively unless otherwise indicated. Procedures relating solely to matters of internal management are not published; however, statements of internal practices and procedures that affect the rights and duties of taxpayers are published.

Revenue rulings represent the conclusions of the Service on the application of the law to the pivotal facts stated in the revenue ruling. In those based on positions taken in rulings to taxpayers or technical advice to Service field offices, identifying details and information of a confidential nature are deleted to prevent unwarranted invasions of privacy and to comply with statutory requirements.

Rulings and procedures reported in the Bulletin do not have the force and effect of Treasury Department Regulations, but they may be used as precedents. Unpublished rulings will not be relied on, used, or cited as precedents by Service personnel in the disposition of other cases. In applying published rulings and procedures, the effect of subsequent legislation, regulations, court decisions, rulings, and procedures must be considered, and Service personnel and others concerned are cautioned against reaching the same conclusions in other cases unless the facts and circumstances are substantially the same.

The Bulletin is divided into four parts as follows:

Part I.—1986 Code.
This part includes rulings and decisions based on provisions of the Internal Revenue Code of 1986.

Part II.—Treaties and Tax Legislation.
This part is divided into two subparts as follows: Subpart A, Tax Conventions, and Subpart B, Legislation and Related Committee Reports.

Part III.—Administrative, Procedural, and Miscellaneous.
To the extent practicable, pertinent cross references to these subjects are contained in the other Parts and Subparts. Also included in this part are Bank Secrecy Act Administrative Rulings. Bank Secrecy Act Administrative Rulings are issued by the Department of the Treasury's Office of the Assistant Secretary (Enforcement).

Part IV.—Items of General Interest.
With the exception of the Notice of Proposed Rulemaking and the disbarment and suspension list included in this part, none of these announcements are consolidated in the Cumulative Bulletins.

The first Bulletin for each month includes a cumulative index for the matters published during the preceding months. These monthly indexes are cumulated on a semiannual basis and are published in the first Bulletin of the succeeding semiannual period, respectively.

For sale by the Superintendent of Documents, U.S. Government Printing Office, Washington, DC 20402.

Section 417.—Definitions and Special Rules for Purposes of Minimum Survivor Annuity Requirements

26 CFR 1.417(e)–1: Restrictions and valuations of distributions from plans subject to sections 401(a)(11) and 417.

T.D. 8768

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Part 1

Valuation of Plan Distributions

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final and temporary regulations.

SUMMARY: This document contains final and temporary regulations that provide guidance to employers in determining the present value of an employee's benefit under a qualified defined benefit pension plan, for purposes of the applicable consent rules and for purposes of determining the amount of a distribution made in any form other than certain nondecreasing annuity forms. These regulations are issued to reflect changes to the applicable law made by the Retirement Protection Act of 1994 (RPA '94), which is part of the Uruguay Round Agreements Act of 1994. RPA '94 amended the law to change the interest rate, and to specify the mortality table, for the purposes described above. These regulations affect employers that maintain qualified defined benefit pension plans, and participants and beneficiaries in those plans.

DATES: *Effective date:* These regulations are effective April 3, 1998.

Applicability date: These regulations apply to plan years beginning after December 31, 1994, except as provided in §1.417(e)–1(d)(8) and (9).

FOR FURTHER INFORMATION CONTACT: Linda S. F. Marshall, (202) 622-6030 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

This document contains amendments to the Income Tax Regulations (26 CFR part 1) under section 417(e). Section 417(e) was amended by the Retirement Protection Act of 1994 (RPA '94). On April 5, 1995, temporary regulations (TD 8591) under section 417(e) were published in the **Federal Register** (60 F.R. 17216). A notice of proposed rulemaking (EE–12–95), cross-referencing the temporary regulations, was published in the **Federal Register** (60 F.R. 17286) on the same day. The temporary regulations provide guidance related to the determination of the present value of an employee's benefit under a qualified defined benefit pension plan in accordance with the rules of section 417(e)(3). After consideration of the public comments received regarding the temporary and proposed regulations, the temporary regulations are replaced and the proposed regulations are adopted as revised by this Treasury decision.

Section 417(e)(3) sets forth rules to be used in determining the present value of an employee's benefit under a qualified defined benefit pension plan, for purposes of the applicable consent rules and for purposes of determining the amount of a distribution. The rules of section 417(e)(3) are also relevant to the application of section 411(a)(11) and section 415(b). Section 411(a)(11) provides that a participant's benefit with a present value that exceeds a statutory threshold can be immediately distributed to a participant only with the participant's consent. The level of this statutory threshold was changed from $3,500 to $5,000 by the Taxpayer Relief Act of 1997, effective for plan years beginning after August 5, 1997. Under section 411(a)(11)(B), as amended by RPA '94, the present value of a participant's benefit is calculated using the rules of section 417(e)(3).

Section 415(b) limits the maximum benefit that can be provided under a qualified defined benefit plan. Under section 415(b)(2)(E)(ii), as amended by RPA '94, the minimum interest rate permitted to be used for certain purposes to determine compliance with the limit under section 415(b) is the applicable interest rate as defined in section 417(e)(3). Because the rules of section 417(e)(3) affect the application of sections 411(a)(11)(B) and 415(b)(2)(E)(ii), the guidance provided by these regulations is relevant to the application of those provisions.

Explanation of provisions

Section 417(e) restricts the ability of certain qualified retirement plans to distribute a participant's benefit under the plan without the consent of the participant and, in many cases, the participant's spouse. The application of these restrictions is determined based on the present value of the participant's benefit. Prior to amendments made by RPA '94, section 417(e)(3) restricted the interest rate to be used under a plan to calculate the present value of a participant's benefit, but did not impose any restrictions on the mortality table to be used for that purpose. Section 767 of RPA '94 modified section 417(e)(3) to provide that the present value of a participant's benefit is not less than the present value calculated by using the applicable mortality table and the applicable interest rate.

In general, comments received on the proposed and temporary regulations were favorable. Thus, the final regulations retain the general structure and substance of the proposed and temporary regulations.

Applicable mortality table

The applicable mortality table under section 417(e)(3) is defined as the table prescribed by the Secretary based on the prevailing commissioners' standard table (described in section 807(d)(5)(A)) used to determine reserves for group annuity contracts issued on the date as of which present value is being determined (without regard to any other subparagraph of section 807(d)(5)). Currently, the prevailing commissioners' standard table is the 1983 Group Annuity Mortality Table. See Rev. Rul. 92–19 (1992–1 C.B. 227). These regulations retain the provision in the temporary regulation that the applica-

ble mortality table as described above is to be prescribed by the Commissioner in revenue rulings, notices or other guidance published in the Internal Revenue Bulletin. The mortality table currently prescribed by the Commissioner is set forth in Rev. Rul. 95–6 (1995–1 C.B. 80), and is based on a fixed blend of 50 percent of the male mortality rates and 50 percent of the female mortality rates from the 1983 Group Annuity Mortality Table.

Applicable interest rate

Under section 417(e)(3), the applicable interest rate is defined as the annual rate of interest on 30-year Treasury securities for the month before the date of distribution or such other time as the Secretary may by regulations prescribe. These regulations retain the rule in the temporary regulations that the applicable interest rate for a month is the annual interest rate on 30-year Treasury securities as specified by the Commissioner for that month. The Commissioner publishes this interest rate for each month by notice, after the end of the month. Currently, this interest rate is the interest rate published in Federal Reserve releases G.13 and H.15 as the average yield on 30-year Treasury Constant Maturities for the month.

The interest rate on 30-year Treasury Constant Maturities published monthly in Federal Reserve releases G.13 and H.15 can also be obtained by telephone from the Public Information Department of the Federal Reserve Bank of New York at (212) 720-6130 (not a toll-free number), or from the Federal Reserve Board of Governors' Internet site at http://www.bog.frb.fed.us/releases. Information regarding subscriptions to Federal Reserve releases G.13 and H.15 can be obtained from the Publications Department of the Federal Reserve Board of Governors at (202) 452-3244 (not a toll-free number).

Time for determining applicable interest rate

Section 417(e)(3)(A)(ii)(II) provides that the applicable interest rate for distributions made during a month is the annual rate of interest on 30-year Treasury securities for the month before the date of distribution or such other time as the Secretary may by regulations prescribe. As an alternative to this monthly change in the applicable interest rate, the temporary regulations permitted selection of a plan quarter or a plan year as a stability period during which the applicable interest rate remains constant, thereby permitting plans to offer greater benefit stability than is provided by the statutory rule. One commentator suggested adding a calendar year and a calendar quarter as additional alternative stability periods for the applicable interest rate, and another suggested adding a plan half-year. The IRS and Treasury have weighed the usefulness of the additional proposed stability periods for taxpayers against the additional complexity that would be added to the regulation, and have added a calendar year and a calendar quarter as additional alternative stability periods.

These regulations retain the rule in the temporary regulations that the applicable interest rate for the stability period may be determined as the 30-year Treasury rate for any one of the five calendar months preceding the first day of the stability period. Permitting this "lookback" of up to five months provides added flexibility and gives plan administrators and participants more time to comply with applicable notice and election requirements using the actual interest rate (instead of an estimate).

Several commentators suggested that regulations permit an average of lookback month interest rates to be used, in lieu of the interest rate for a single lookback month, to minimize interest rate fluctuations. These regulations adopt this suggestion, and permit an average interest rate based on consecutive permitted lookback months to be used for this purpose.

Several commentators suggested that a plan be allowed to provide for different applicable interest rates for each portion of the plan that independently meets the requirements of sections 410(b) and 401(a)(26). The IRS and Treasury have determined, however, that there is insufficient basis for adopting a definition of a "plan" that is different from the general definition set forth in §1.414(l)–1(b)(1).

Exceptions from the requirements of section 417(e)(3)

The temporary regulations provided an exception from the requirements of section 417(e)(3) and §1.417(e)–1T(d) for the amount of a distribution under a nondecreasing annuity payable for a period not less than the life of the participant or, in the case of a QPSA, the life of the surviving spouse. For purposes of this exception, a nondecreasing annuity included a QJSA, a QPSA, and an annuity that decreased merely because of the cessation or reduction of Social Security supplements or qualified disability payments (as defined in section 411(a)(9)). This exception was identical to the exception provided under former final regulations. Several commentators pointed out that this exception did not cover several other types of annuity forms of distribution that were nondecreasing during the life of the participant, and suggested that the regulations be changed to provide additional exceptions for these additional annuity forms of distribution.

The IRS and Treasury have determined that it is appropriate to provide additional exceptions for these benefit forms. Accordingly, under the final regulations, section 417(e)(3) and §1.417(e)–1(d) do not apply to the amount of a distribution paid in the form of an annual benefit that does not decrease during the life of the participant, or, in the case of a QPSA, the life of the participant's spouse; or that decreases during the life of the participant merely because of the death of the survivor annuitant (but only if the reduction is to a level not below 50% of the annual benefit payable before the death of the survivor annuitant) or merely because of the cessation or reduction of Social Security supplements or qualified disability benefits. Also, under Q&A–2 of Rev. Rul. 98–1 (1998–2 I.R.B. 1), the interest rate prescribed by section 415(b)(2)(E)(ii) does not apply to these forms of benefit.

Effective dates

These regulations generally apply to plan years beginning after December 31, 1994.

Under section 417(e)(3)(B) and these regulations, the general effective date for the RPA '94 rules is delayed for certain plans until the first plan year that begins after December 31, 1999, unless an employer takes earlier action. The delayed effective date applies to a plan adopted

and in effect before December 8, 1994, if the provisions of the plan in effect on December 7, 1994, met the requirements of section 417(e)(3) as in effect on December 7, 1994. For such a plan, the determination of whether a distribution made before the first day of the first plan year that begins after December 31, 1999, satisfies section 417(e) is made under the provisions of the plan in effect on December 7, 1994, if the annuity starting date for the distribution occurs before the date a plan amendment applying both the applicable mortality table and the applicable interest rate rules added by RPA '94 is adopted or, if later, is made effective. Thus, under section 417(e)(3)(B) and these regulations, a plan that was adopted and in effect before December 8, 1994, and the provisions of which, as in effect on December 7, 1994, met the requirements of section 417(e)(3) as in effect on that date, cannot be amended to provide a different method of calculating the present value of a distribution under section 417(e)(3) effective before the date a plan amendment applying both the applicable mortality table and the applicable interest rate rules added by RPA '94 is adopted or, if later, is made effective.

One commentator inquired whether, where a plan is spun off from another plan during the optional delayed effective date period, both plans are required to be amended to apply the applicable mortality table and the applicable interest rate rules added by RPA '94 effective on the same date. Because these rules apply on a plan by plan basis, the plans are not required to be amended effective on the same date. One other commentator suggested that the regulations be changed to permit a plan to provide for different optional delayed effective dates for each separate benefit structure that independently meets the requirements of section 401(a)(4). Section 417(e)(3)(B) requires a single effective date for a plan amendment applying the applicable mortality table and the applicable interest rate rules added by RPA '94. Therefore, this suggestion is inconsistent with the statute. Of course, a plan amendment that applies the applicable mortality table and the applicable interest rate rules added by RPA '94 may provide for temporary or permanent use of interest and mortality assumptions for specified participant groups that result in larger distributions than the minimum required under these RPA '94 rules, provided that other qualification requirements (such as section 401(a)(4)) are satisfied.

These regulations restate the rules applicable to plan years beginning before January 1, 1995, without substantive change. Those pre-1995 rules also apply to later plan years, to the extent that the application of the RPA '94 rules is delayed as described above.

In addition, section 767(d)(1) of RPA '94 permits an employer to elect to accelerate the effective date of the RPA '94 rules, and hence these regulations, in order to apply the RPA '94 rules to distributions with annuity starting dates occurring after December 7, 1994, in plan years beginning before January 1, 1995. An employer that makes a plan amendment applying the applicable mortality table and the applicable interest rate rules of these regulations is treated as making this election as of the date the plan amendment is adopted or, if later, is made effective.

Relationship with section 411(d)(6)

Section 411(d)(6) provides that a plan does not satisfy the requirements of section 411 if the accrued benefit of a participant is decreased by a plan amendment. In general, a plan amendment that changes the interest rate or the mortality assumptions used for purposes of determining the amount of any accrued benefit in any preexisting optional form is subject to section 411(d)(6). Consistent with both the temporary regulations and the prior final regulations, these regulations provide limited section 411(d)(6) relief for certain plan amendments that change the time for determining the applicable interest rate. A plan amendment that changes the time for determining the applicable interest rate will not be treated as violating section 411(d)(6) if each distribution made until one year after the later of the effective date or the adoption date of the amendment is calculated using the time for determining the applicable interest rate as provided before or after the amendment, whichever produces the larger benefit. For this purpose, all other plan provisions must be applied as in effect after the amendment.

Section 767(d)(2) of RPA '94 provides that a participant's accrued benefit is not considered to be reduced in violation of section 411(d)(6) merely because the benefit is determined in accordance with the applicable interest rate rules and the applicable mortality table rules of section 417(e)(3)(A), as amended by RPA '94. These regulations provide that an amendment replacing an interest rate used for purposes of section 417(e)(3) qualifies for this section 411(d)(6) relief if the interest rate replaced is the Pension Benefit Guaranty Corporation (PBGC) interest rate or a rate based on the PBGC interest rate. Pursuant to suggestions made by several commentators, these regulations clarify that the interest rates that may be replaced pursuant to this section 411(d)(6) relief include an interest rate based on the average of the PBGC interest rates over a specified period. In addition, pursuant to suggestions made by two commentators, the final regulations clarify the relationship between the various types of section 411(d)(6) relief under the regulations, and provide some additional flexibility to employers in determining how to transition between the PBGC interest rate and the applicable interest rate and applicable mortality table, where the transition is combined with a change in the time for determining the interest rate.

One commentator asked whether the section 411(d)(6) relief for plan amendments adopting the applicable mortality table and the applicable interest rate rules applies with respect to terminated vested participants. Because the section 411(d)(6) relief provided under section 767(d)(2) of RPA '94 applies in the same manner with respect to active and terminated participants, the regulations likewise do not distinguish terminated vested participants from other participants in this regard.

Several commentators requested that the regulations be amended to provide unconditional section 411(d)(6) relief for plan amendments adopting the applicable interest rate and applicable mortality table rules of RPA '94 regardless of changes in the time for determining the applicable interest rate. The IRS and Treasury have determined that providing some additional flexibility to employers in determining how to transition between the PBGC interest rate and the applicable interest rate and applicable mortality table, as discussed above, where the transition is combined with a change in the time for

determining the interest rate, strikes an appropriate balance between the practical concerns of employers and the rights of participants.

These regulations further provide that, where a plan provided for the use of an interest rate not based on the PBGC interest rate prescribed by section 417(e)(3) as in effect before amendments made by RPA '94, a plan amendment that eliminates the use of that interest rate and the associated mortality table may result in a reduction of a participant's accrued benefit, which would violate the requirements of section 411(d)(6). Two commentators suggested that final regulations provide section 411(d)(6) relief for plan amendments that eliminate the use of an interest rate not based on the PBGC interest rate, for plan amendments that adopt the applicable interest rate and applicable mortality table rules of RPA '94. Another commentator requested that final regulations provide for similar section 411(d)(6) relief, but only for mandatory distributions that are permitted pursuant to the rules of section 411(a)(11). The IRS and Treasury have determined that section 767(d)(2) of RPA '94 does not support a grant of section 411(d)(6) relief with respect to plan amendments eliminating interest rates that are not based on the PBGC interest rate.

These regulations provide examples of the application of section 411(d)(6) and the special rule of section 767(d)(2) of RPA '94, including an example illustrating the use of a phase-in that provides for a smoother transition from the plan's former terms to the new rules. In addition, these regulations provide section 411(d)(6) relief for certain plan amendments that eliminate use of the applicable interest rate and the applicable mortality table with respect to distribution forms that are newly excepted from the application of section 417(e)(3) by these regulations.

The PBGC has advised the IRS and Treasury that it has not made any decision at this time on whether it will continue to calculate and publish the relevant interest rates after the year 2000. Therefore, in amending plans to comply with these regulations, employers should not rely on the continued determination and publication of these rates by the PBGC beyond the year 2000.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in EO 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and because the notice of proposed rulemaking preceding the regulations was issued prior to March 29, 1996, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Internal Revenue Code, the notice of proposed rulemaking preceding these regulations was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Drafting Information

The principal author of these regulations is Linda S. F. Marshall, Office of the Associate Chief Counsel (Employee Benefits and Exempt Organizations). However, other personnel from the IRS and Treasury Department participated in their development.

Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by adding an entry in numerical order to read as follows:

Authority 26 U.S.C. 7805 * * *

Section 1.417(e)–1 also issued under 26 U.S.C. 417(e)(3)(A)(ii)(II). * * *

Par. 2. In §1.417(e)–1, paragraph (d) is revised to read as follows:

§1.417(e)–1 Restrictions and valuations of distributions from plans subject to sections 401(a)(11) and 417.

* * * * *

(d) *Present value requirement*—(1) *General rule.* A defined benefit plan must provide that the present value of any accrued benefit and the amount (subject to sections 411(c)(3) and 415) of any distribution, including a single sum, must not be less than the amount calculated using the applicable interest rate described in paragraph (d)(3) of this section (determined for the month described in paragraph (d)(4) of this section) and the applicable mortality table described in paragraph (d)(2) of this section. The present value of any optional form of benefit cannot be less than the present value of the normal retirement benefit determined in accordance with the preceding sentence. The same rules used for the plan under this paragraph (d) must also be used to compute the present value of the benefit for purposes of determining whether consent for a distribution is required under paragraph (b) of this section.

(2) *Applicable mortality table.* The applicable mortality table is the mortality table based on the prevailing commissioners' standard table (described in section 807(d)(5)(A)) used to determine reserves for group annuity contracts issued on the date as of which present value is being determined (without regard to any other subparagraph of section 807(d)(5)), that is prescribed by the Commissioner in revenue rulings, notices, or other guidance published in the Internal Revenue Bulletin (see §601.601(d)(2)(ii)(b) of this chapter). The Commissioner may prescribe rules that apply in the case of a change to the prevailing commissioners' standard table (described in section 807(d)(5)(A)) used to determine reserves for group annuity contracts, in revenue rulings, notices, or other guidance published in the Internal Revenue Bulletin (see §601.601(d)(2)(ii)(b) of this chapter).

(3) *Applicable interest rate*—(i) *General rule.* The applicable interest rate for a month is the annual interest rate on 30-year Treasury securities as specified by the Commissioner for that month in revenue rulings, notices or other guidance published in the Internal Revenue Bulletin (see §601.601(d)(2)(ii)(b) of this chapter).

(ii) *Example.* This example illustrates the rules of this paragraph (d)(3):

Example. Plan A is a calendar year plan. For its 1995 plan year, Plan A provides that the applicable mortality table is the table described in Rev. Rul. 95–6 (1995–1 C.B. 80), and that the applicable interest rate is the annual interest rate on 30-year Treasury securities as specified by the Commissioner for the first full calendar month preceding the calendar month that contains the annuity starting date. Participant P is age 65 in January 1995, which is the

month that contains P's annuity starting date. P has an accrued benefit payable monthly of $1,000 and has elected to receive a distribution in the form of a single sum in January 1995. The annual interest rate on 30-year Treasury securities as published by the Commissioner for December 1994 is 7.87 percent. To satisfy the requirements of section 417(e)(3) and this paragraph (d), the single sum received by P may not be less than $111,351.

(4) *Time for determining interest rate*—(i) *General rule.* Except as provided in paragraph (d)(4)(iv) or (v) of this section, the applicable interest rate to be used for a distribution is the rate determined under paragraph (d)(3) of this section for the applicable lookback month. The applicable lookback month for a distribution is the lookback month (as described in paragraph (d)(4)(iii) of this section) for the month (or other longer stability period described in paragraph (d)(4)(ii) of this section) that contains the annuity starting date for the distribution. The time and method for determining the applicable interest rate for each participant's distribution must be determined in a consistent manner that is applied uniformly to all participants in the plan.

(ii) *Stability period.* A plan must specify the period for which the applicable interest rate remains constant. This stability period may be one calendar month, one plan quarter, one calendar quarter, one plan year, or one calendar year.

(iii) *Lookback month.* A plan must specify the lookback month that is used to determine the applicable interest rate. The lookback month may be the first, second, third, fourth, or fifth full calendar month preceding the first day of the stability period.

(iv) *Permitted average interest rate.* A plan may apply the rules of paragraph (d)(4)(i) of this section by substituting a permitted average interest rate with respect to the plan's stability period for the rate determined under paragraph (d)(3) of this section for the applicable lookback month for the stability period. For this purpose, a permitted average interest rate with respect to a stability period is an interest rate that is computed by averaging the applicable interest rates determined under paragraph (d)(3) of this section for two or more consecutive months from among the first, second, third, fourth, and fifth calendar months preceding the first day of the stability period. For this paragraph (d)(4)(iv) to apply, a plan must specify the manner in which the permitted average interest rate is computed.

(v) *Additional determination dates.* The Commissioner may prescribe, in revenue rulings, notices or other guidance published in the Internal Revenue Bulletin (see §601.601(d)(2)(ii)(*b*)), other times that a plan may provide for determining the applicable interest rate.

(vi) *Example.* This example illustrates the rules of this paragraph (d)(4):

Example. Employer X maintains Plan A, a calendar year plan. Employer X wishes to amend Plan A so that the applicable interest rate will remain fixed for each plan quarter, and so that the applicable interest rate for distributions made during each plan quarter can be determined approximately 80 days before the beginning of the plan quarter. To comply with the provisions of this paragraph (d)(4), Plan A is amended to provide that the applicable interest rate is the annual interest rate on 30-year Treasury securities as specified by the Commissioner for the fourth calendar month preceding the first day of the plan quarter during which the annuity starting date occurs.

(5) *Use of alternative interest rate and mortality table.* If a plan provides for use of an interest rate or mortality table other than the applicable interest rate or the applicable mortality table, the plan must provide that a participant's benefit must be at least as great as the benefit produced by using the applicable interest rate and the applicable mortality table. For example, if a plan provides for use of an interest rate of 7% and the UP–1984 Mortality Table (see §1.401(a)(4)–12, *Standard mortality table*) in calculating single-sum distributions, the plan must provide that any single-sum distribution is calculated as the greater of the single-sum benefit calculated using 7% and the UP–1984 Mortality Table and the single-sum benefit calculated using the applicable interest rate and the applicable mortality table.

(6) *Exceptions.* This paragraph (d) (other than the provisions relating to section 411(d)(6) requirements in paragraph (d)(10) of this section) does not apply to the amount of a distribution paid in the form of an annual benefit that—

(i) Does not decrease during the life of the participant, or, in the case of a QPSA, the life of the participant's spouse; or

(ii) Decreases during the life of the participant merely because of—

(A) The death of the survivor annuitant (but only if the reduction is to a level not below 50% of the annual benefit payable before the death of the survivor annuitant); or

(B) The cessation or reduction of Social Security supplements or qualified disability benefits (as defined in section 411(a)(9)).

(7) *Defined contribution plans.* Because the accrued benefit under a defined contribution plan equals the account balance, a defined contribution plan is not subject to the requirements of this paragraph (d), even though it is subject to section 401(a)(11).

(8) *Effective date*—(i) *In general.* This paragraph (d) is effective for distributions with annuity starting dates in plan years beginning after December 31, 1994.

(ii) *Optional delayed effective date of Retirement Protection Act of 1994 (RPA '94)(108 Stat. 5012) rules for plans adopted and in effect before December 8, 1994.* For a plan adopted and in effect before December 8, 1994, the application of the rules relating to the applicable mortality table and applicable interest rate under paragraphs (d)(2) through (4) of this section is delayed to the extent provided in this paragraph (d)(8)(ii), if the plan provisions in effect on December 7, 1994, met the requirements of section 417(e)(3) and §1.417(e)–1(d) as in effect on December 7, 1994 (as contained in 26 CFR part 1 revised April 1, 1995). In the case of a distribution from such a plan with an annuity starting date that precedes the optional delayed effective date described in paragraph (d)(8)(iv) of this section, and that precedes the first day of the first plan year beginning after December 31, 1999, the rules of paragraph (d)(9) of this section (which generally apply to distributions with annuity starting dates in plan years beginning before January 1, 1995) apply in lieu of the rules of paragraphs (d)(2) through (4) of this section. The interest rate under the rules of paragraph (d)(9) of this section is determined under the provisions of the plan as in effect on December 7, 1994, reflecting the interest rate or rates published by the Pension Benefit Guaranty Corporation (PBGC) and the provisions of the plan for determining the date on which the interest rate is fixed. The above described interest rate or rates published by the PBGC are those determined by the PBGC (for the date determined under those plan provisions) pursuant to the methodology under the regulations of the PBGC for determining the present

value of a lump sum distribution on plan termination under 29 CFR part 2619 that were in effect on September 1, 1993 (as contained in 29 CFR part 2619 revised July 1, 1994).

(iii) *Optional accelerated effective date of RPA '94 rules.* This paragraph (d) is also effective for a distribution with an annuity starting date after December 7, 1994, during a plan year beginning before January 1, 1995, if the employer elects, on or before the annuity starting date, to make the rules of this paragraph (d) effective with respect to the plan as of the optional accelerated effective date described in paragraph (d)(8)(iv) of this section. An employer is treated as making this election by making the plan amendments described in paragraph (d)(8)(iv) of this section.

(iv) *Determination of delayed or accelerated effective date by plan amendment adopting RPA '94 rules.* The optional delayed effective date of paragraph (d)(8)(ii) of this section, or the optional accelerated effective date of paragraph (d)(8)(iii) of this section, whichever is applicable, is the date plan amendments applying both the applicable mortality table of paragraph (d)(2) of this section and the applicable interest rate of paragraph (d)(3) of this section are adopted or, if later, are made effective.

(9) *Plan years beginning before January 1, 1995*—(i) *Interest rate.* (A) For distributions made in plan years beginning after December 31, 1986, and before January 1, 1995, the following interest rate described in paragraph (d)(9)(i)-(A)(*1*) or (*2*) of this section, whichever applies, is substituted for the applicable interest rate for purposes of this section—

(*1*) The rate or rates that would be used by the PBGC for a trusteed single-employer plan to value the participant's (or beneficiary's) vested benefit (PBGC interest rate) if the present value of such benefit does not exceed $25,000; or

(*2*) 120 percent of the PBGC interest rate, as determined in accordance with paragraph (d)(9)(i)(A)(*1*) of this section, if such present value exceeds $25,000. In no event shall the present value determined by use of 120 percent of the PBGC interest rate result in a present value less than $25,000.

(B) The PBGC interest rate may be a series of interest rates for any given date. For example, the PBGC interest rate for immediate annuities for November 1994 is 6%, and the PBGC interest rates for the deferral period for that month are as follows: 5.25% for the first 7 years of the deferral period, 4% for the following 8 years of the deferral period, and 4% for the remainder of the deferral period. For November 1994, 120 percent of the PBGC interest rate is 7.2% (1.2 times 6%) for an immediate annuity, 6.3% (1.2 times 5.25%) for the first 7 years of the deferral period, 4.8% (1.2 times 4%) for the following 8 years of the deferral period, and 4.8% (1.2 times 4%) for the remainder of the deferral period. The PBGC interest rates are the interest rates that would be used (as of the date of the distribution) by the PBGC for purposes of determining the present value of that benefit upon termination of an insufficient trusteed single employer plan. Except as otherwise provided by the Commissioner, the PBGC interest rates are determined by PBGC regulations. See subpart B of 29 CFR part 4044 for the applicable PBGC rates.

(ii) *Time for determining interest rate.* (A) Except as provided in paragraph (d)(9)(ii)(B) of this section, the PBGC interest rate or rates are determined on either the annuity starting date or the first day of the plan year that contains the annuity starting date. The plan must provide which date is applicable.

(B) The plan may provide for the use of any other time for determining the PBGC interest rate or rates provided that such time is not more than 120 days before the annuity starting date if such time is determined in a consistent manner and is applied uniformly to all participants.

(C) The Commissioner may, in revenue rulings, notices or other guidance published in the Internal Revenue Bulletin (see §601.601(d)(2)(ii)(b)), prescribe other times for determining the PBGC interest rate or rates.

(iii) *No applicable mortality table.* In the case of a distribution to which this paragraph (d)(9) applies, the rules of this paragraph (d) are applied without regard to the applicable mortality table described in paragraph (d)(2) of this section.

(10) *Relationship with section 411(d)(6)*—(i) *In general.* A plan amendment that changes the interest rate, the time for determining the interest rate, or the mortality assumptions used for the purposes described in paragraph (d)(1) of this section is subject to section 411(d)(6). But see §1.411(d)–4, Q&A–2(b)(2)(v) (regarding plan amendments relating to involuntary distributions). In addition, a plan amendment that changes the interest rate or the mortality assumptions used for the purposes described in paragraph (d)(1) of this section merely to eliminate use of the interest rate described in paragraph (d)(3) or paragraph (d)(9) of this section, or the applicable mortality table, with respect to a distribution form described in paragraph (d)(6) of this section, for distributions with annuity starting dates occurring after a specified date that is after the amendment is adopted, does not violate the requirements of section 411(d)(6) if the amendment is adopted on or before the last day of the last plan year ending before January 1, 2000.

(ii) *Section 411(d)(6) relief for change in time for determining interest rate.* Notwithstanding the general rule of paragraph (d)(10)(i) of this section, if a plan amendment changes the time for determining the applicable interest rate (including an indirect change as a result of a change in plan year), the amendment will not be treated as reducing accrued benefits in violation of section 411(d)(6) merely on account of this change if the conditions of this paragraph (d)(10)(ii) are satisfied. If the plan amendment is effective on or after the adoption date, any distribution for which the annuity starting date occurs in the one-year period commencing at the time the amendment is effective must be determined using the interest rate provided under the plan determined at either the date for determining the interest rate before the amendment or the date for determining the interest rate after the amendment, whichever results in the larger distribution. If the plan amendment is adopted retroactively (that is, the amendment is effective prior to the adoption date), the plan must use the interest rate determination date resulting in the larger distribution for the period beginning with the effective date and ending one year after the adoption date.

(iii) *Section 411(d)(6) relief for plan amendments pursuant to changes to section 417 made by RPA '94 providing for statutory interest rate determination date.*

Notwithstanding the general rule of paragraph (d)(10)(i) of this section, except as provided in paragraph (d)(10)(vi)(B) of this section, a participant's accrued benefit is not considered to be reduced in violation of section 411(d)(6) merely because of a plan amendment that changes any interest rate or mortality assumption used to calculate the present value of a participant's benefit under the plan, if the following conditions are satisfied—

(A) The amendment replaces the PBGC interest rate (or an interest rate or rates based on the PBGC interest rate) as the interest rate used under the plan in determining the present value of a participant's benefit under this paragraph (d); and

(B) After the amendment is effective, the present value of a participant's benefit under the plan cannot be less than the amount calculated using the applicable mortality table and the applicable interest rate for the first full calendar month preceding the calendar month that contains the annuity starting date.

(iv) *Section 411(d)(6) relief for plan amendments pursuant to changes to section 417 made by RPA '94 providing for prior determination date or up to two months earlier.* Notwithstanding the general rule of paragraph (d)(10)(i) of this section, except as provided in paragraph (d)(10)(vi)(B) of this section, a participant's accrued benefit is not considered to be reduced in violation of section 411(d)(6) merely because of a plan amendment that changes any interest rate or mortality assumption used to calculate the present value of a participant's benefit under the plan, if the following conditions are satisfied—

(A) The amendment replaces the PBGC interest rate (or an interest rate or rates based on the PBGC interest rate) as the interest rate used under the plan in determining the present value of a participant's benefit under this paragraph (d); and

(B) After the amendment is effective, the present value of a participant's benefit under the plan cannot be less than the amount calculated using the applicable mortality table and the applicable interest rate, but only if the applicable interest rate is the annual interest rate on 30-year Treasury securities for the calendar month that contains the date as of which the PBGC interest rate (or an interest rate or rates based on the PBGC interest rate) was determined immediately before the amendment, or for one of the two calendar months immediately preceding such month.

(v) *Section 411(d)(6) relief for plan amendments pursuant to changes to section 417 made by RPA '94 providing for other interest rate determination date.* Notwithstanding the general rule of paragraph (d)(10)(i) of this section, except as provided in paragraph (d)(10)(vi)(B) of this section, a participant's accrued benefit is not considered to be reduced in violation of section 411(d)(6) merely because of a plan amendment that changes any interest rate or mortality assumption used to calculate the present value of a participant's benefit under the plan, if the following conditions are satisfied—

(A) The amendment replaces the PBGC interest rate (or an interest rate or rates based on the PBGC interest rate) as the interest rate used under the plan in determining the present value of a participant's benefit under this paragraph (d);

(B) After the amendment is effective, the present value of a participant's benefit under the plan cannot be less than the amount calculated using the applicable mortality table and the applicable interest rate; and

(C) The plan amendment satisfies either the condition of paragraph (d)(10)(ii) of this section (determined using the interest rate provided under the terms of the plan after the effective date of the amendment) or the special early transition interest rate rule of paragraph (d)(10)(vi)(C) of this section.

(vi) *Special rules*—(A) *Provision of temporary additional benefits.* A plan amendment described in paragraph (d)(10)(iii), (iv), or (v) of this section is not considered to reduce a participant's accrued benefit in violation of section 411(d)(6) even if the plan amendment provides for temporary additional benefits to accommodate a more gradual transition from the plan's old interest rate to the new rules.

(B) *Replacement of non-PBGC interest rate.* The section 411(d)(6) relief provided in paragraphs (d)(10)(iii) through (v) of this section does not apply to a plan amendment that replaces an interest rate other than the PBGC interest rate (or an interest rate or rates based on the PBGC interest rate) as an interest rate used under the plan in determining the present value of a participant's benefit under this paragraph (d). Thus, the accrued benefit determined using that interest rate and the associated mortality table is protected under section 411(d)(6). For purposes of this paragraph (d), an interest rate is based on the PBGC interest rate if the interest rate is defined as a specified percentage of the PBGC interest rate, the PBGC interest rate minus a specified number of basis points, or an average of such interest rates over a specified period.

(C) *Special early transition interest rate rule for paragraph (d)(10)(v).* A plan amendment satisfies the special rule of this paragraph (d)(10)(vi)(C) if any distribution for which the annuity starting date occurs in the one-year period commencing at the time the plan amendment is effective is determined using whichever of the following two interest rates results in the larger distribution—

(*1*) The interest rate as provided under the terms of the plan after the effective date of the amendment, but determined at a date that is either one month or two months (as specified in the plan) before the date for determining the interest rate used under the terms of the plan before the amendment; or

(*2*) The interest rate as provided under the terms of the plan after the effective date of the amendment, determined at the date for determining the interest rate after the amendment.

(vii) *Examples.* The provisions of this paragraph (d)(10) are illustrated by the following examples:

Example 1. On December 31, 1994, Plan A provided that all single-sum distributions were to be calculated using the UP–1984 Mortality Table and 100% of the PBGC interest rate for the date of distribution. On January 4, 1995, and effective on February 1, 1995, Plan A was amended to provide that all single-sum distributions are calculated using the applicable mortality table and the annual interest rate on 30-year Treasury securities for the first full calendar month preceding the calendar month that contains the annuity starting date. Pursuant to paragraph (d)(10)(iii) of this section, this amendment of Plan A is not considered to reduce the accrued benefit of any participant in violation of section 411(d)(6).

Example 2. On December 31, 1994, Plan B provided that all single-sum distributions were to be calculated using the UP–1984 Mortality Table and an interest rate equal to the lesser of 100% of the PBGC

interest rate for the date of distribution, or 6%. On January 4, 1995, and effective on February 1, 1995, Plan B was amended to provide that all single-sum distributions are calculated using the applicable mortality table and the annual interest rate on 30-year Treasury securities for the second full calendar month preceding the calendar month that contains the annuity starting date. Pursuant to paragraph (d)(10)(iv) of this section, this amendment of Plan B is not considered to reduce the accrued benefit of any participant in violation of section 411(d)(6) merely because of the replacement of the PBGC interest rate. However, under paragraph (d)(10)(vi)(B) of this section, the section 411(d)(6) relief provided in paragraphs (d)(10)(iii) through (v) of this section does not apply to a plan amendment that replaces an interest rate other than the PBGC interest rate (or a rate based on the PBGC interest rate). Therefore, pursuant to paragraph (d)(10)(vi)(B) of this section, to satisfy the requirements of section 411(d)(6), the plan must provide that the single-sum distribution payable to any participant must be no less than the single-sum distribution calculated using the UP–1984 Mortality Table and an interest rate of 6%, based on the participant's benefits under the plan accrued through January 31, 1995, and based on the participant's age at the annuity starting date.

Example 3. On December 31, 1994, Plan C, a calendar year plan, provided that all single sum distributions were to be calculated using the UP–1984 Mortality Table and an interest rate equal to the PBGC interest rate for January 1 of the plan year. On March 1, 1995, and effective on July 1, 1995, Plan C was amended to provide that all single-sum distributions are calculated using the applicable mortality table and the annual interest rate on 30-year Treasury securities for August of the year before the plan year that contains the annuity starting date. The plan amendment provides that each distribution with an annuity starting date after June 30, 1995, and before July 1, 1996, is calculated using the 30-year Treasury rate for August of the year before the plan year that contains the annuity starting date, or the 30-year Treasury rate for January of the plan year that contains the annuity starting date, whichever produces the larger benefit. Pursuant to paragraph (d)(10)(v) of this section, the amendment of Plan C is not considered to have reduced the accrued benefit of any participant in violation of section 411(d)(6).

Example 4. (a) Employer X maintains Plan D, a calendar year plan. As of December 7, 1994, Plan D provided for single-sum distributions to be calculated using the PBGC interest rate as of the annuity starting date for distributions not greater than $25,000, and 120% of that interest rate (but not an interest rate producing a present value less than $25,000) for distributions over $25,000. Employer X wishes to delay the effective date of the RPA '94 rules for a year, and to provide for an extended transition from the use of the PBGC interest rate to the new applicable interest rate under section 417(e)(3). On December 1, 1995, and effective on January 1, 1996, Employer X amends Plan D to provide that single-sum distributions are determined as the sum of—

(i) The single-sum distribution calculated based on the applicable mortality table and the annual interest rate on 30-year Treasury securities for the first full calendar month preceding the calendar month that contains the annuity starting date; and

(ii) A transition amount.

(b) The amendment provides that the transition amount for distributions in the years 1996–99 is a transition percentage of the excess, if any, of the amount that the single-sum distribution would have been under the plan provisions in effect prior to this amendment over the amount of the single sum described in paragraph (a)(i) of this *Example 4.* The transition percentages are 80% for 1996, decreasing to 60% for 1997, 40% for 1998 and 20% for 1999. The amendment also provides that the transition amount is zero for plan years beginning on or after the year 2000. Pursuant to paragraphs (d)(10)(iii) and (vi)(A) of this section, the amendment of Plan D is not considered to have reduced the accrued benefit of any participant in violation of section 411(d)(6).

Example 5. On December 31, 1994, Plan E, a calendar year plan, provided that all single sum distributions were to be calculated using the UP-1984 Mortality Table and an interest rate equal to the PBGC interest rate for January 1 of the plan year. On March 1, 1995, and effective on July 1, 1995, Plan E was amended to provide that all single-sum distributions are calculated using the applicable mortality table and the annual interest rate on 30-year Treasury securities for August of the year before the plan year that contains the annuity starting date. The plan amendment provides that each distribution with an annuity starting date after June 30, 1995, and before July 1, 1996, is calculated using the 30-year Treasury rate for August of the year before the plan year that contains the annuity starting date, or the 30-year Treasury rate for November of the plan year preceding the plan year that contains the annuity starting date, whichever produces the larger benefit. Pursuant to paragraphs (d)(10)(v) and (vi)(C) of this section, the amendment of Plan E is not considered to have reduced the accrued benefit of any participant in violation of section 411(d)(6).

Par. 3. In §1.417(e)–1T, paragraph (d) is revised to read as follows:

§1.417(e)–1T Restrictions and valuations of distributions from plans subject to sections 401(a)(11) and 417. (Temporary)

* * * * *

(d) For rules regarding the present value of a participant's accrued benefit and related matters, see §1.417(e)–1(d).

Michael P. Dolan,
Deputy Commissioner of Internal Revenue.

Approved March 30, 1998.

Donald C. Lubick,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on April 3, 1998, 8:45 a.m., and published in the issue of the Federal Register for April 7, 1998, 63 F.R. 16895)

Part IV. Items of General Interest

Notice of Proposed Rulemaking

Travel and Tour Activities of Tax Exempt Organizations

REG–121268–97

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains proposed regulations clarifying when the travel and tour activities of tax exempt organizations are substantially related to the purposes for which exemption was granted. These proposed regulations are intended to augment the guidance that currently exists with respect to travel tours and the unrelated business income tax.

DATES: Written comments and requests for a public hearing must be received by July 22, 1998.

ADDRESSES: Send submissions to: CC:DOM:CORP:R (REG–121268–97), room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered between the hours of 8 a.m. and 5 p.m. to: CC:DOM:CORP:R (REG–121268–97), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue NW, Washington, DC. Alternatively, taxpayers may submit comments electronically via the internet by selecting the "Tax Regs" option on the IRS Home Page, or by submitting comments directly to the IRS internet site at http://www.irs.ustreas.gov/prod/tax_regs/comments.html.

FOR FURTHER INFORMATION CONTACT: Robin Ehrenberg, (202) 622-6080 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

An organization generally exempt from tax under section 501(a) of the Internal Revenue Code ("Code") must pay tax on its unrelated business taxable income, as defined in section 512. Section 512(a)(1) defines unrelated business taxable income ("UBTI") as the gross income derived by any organization from any unrelated trade or business (as defined in section 513) regularly carried on by the organization, less the deductions which are directly connected with the conduct of the trade or business. Gross income from an unrelated trade or business and any deductions directly connected to that trade or business are both computed in accordance with the general income tax rules of chapter 1 of the Internal Revenue Code, subject to the modifications provided in section 512(b).

Section 513(a) generally defines an unrelated trade or business as any trade or business the conduct of which is not substantially related (aside from the need of an organization for income or funds or the use it makes of the profits derived) to the exercise or performance by the organization of its charitable, educational, or other purpose or function constituting the basis for its exemption under section 501.

A "trade or business" is defined in Section 1.513–1(b) of the Income Tax Regulations as having the same meaning it has for purposes of section 162, and "generally includes any activity carried on for the production of income from the sale of goods or performance of services." The key test of whether an activity constitutes a trade or business is whether the activity was conducted with a profit motive. See *U.S. v. American Bar Endowment,* 477 U.S. 105 (1986); *Professional Insurance Agents of Michigan v. Commissioner* 726 F.2d 1097 (6th Cir. 1983); *National Water Well Association v. Commissioner,* 92 T.C. 75 (1989). The regulations further provide that an activity conducted for the production of income does not lose its character as a business "merely because [it is] carried on within a larger aggregate of similar activities or within a larger complex of other endeavors which may, or may not, be related to the exempt purposes of the organization." This "fragmentation rule," as it is commonly known, may result in different treatment of related activities under the unrelated business income tax.

Section 1.513–1(d)(2) of the Income Tax Regulations provides that a trade or business is "substantially related" to exempt purposes only where the conduct of the business activities has a substantial causal relationship to the achievement of the exempt purposes (other than through the production of income) of the organization conducting the trade or business. Thus, a trade or business is substantially related for purposes of section 513 only if the conduct of the trade or business contributes importantly to the accomplishment of the organization's exempt purposes.

In recent years, taxpayers and Congress have asked the IRS to publish guidance addressing questions relating to the unrelated business income tax treatment of income generated from travel tours conducted by tax exempt organizations. Although the IRS has issued a number of revenue rulings addressing situations in which tax exempt organizations sponsor travel tours, most of these rulings have analyzed whether an organization that offers travel tours as its primary activity can qualify as a charitable or educational organization described in section 501(c)(3) of the Code.

Rev. Rul. 67–327, 1967–2 C.B. 187, holds that an organization whose purpose is to arrange group tours for students and faculty of a university in order to allow them to travel abroad does not qualify for exemption because the organization operates essentially as a commercial travel agency. The ruling concludes that the organization's activities are not "educational" as that term is defined in Treas. Reg. § 1.501(c)(3)–1(d)(3)(i)(a), because they do not provide instruction or training of individuals for the purpose of improving or developing their capabilities.

In contrast, in Rev. Rul. 69–400, 1969–2 C.B. 114, an organization that selects students and faculty members interested in a certain foreign history and culture and enrolls them at foreign universities and arranges for on-site tours conducted by local scholars that complement classroom studies, is held to be exempt. Rev. Rul. 69–400 distinguishes Rev. Rul. 67–327 on the basis that the organization in the later ruling is arranging for instruction not just travel.

Rev. Rul. 70–534, 1970–2 C.B. 113, describes an organization that conducts travel study tours as its primary activity.

Tours are geared toward students, but others can take the tours as long as they participate in the mandatory study programs. Organized study, taught by certified teachers, is conducted five to six hours a day, and a library of materials related to the courses being taught is available. Exams are given, each student is graded and a state board of education allows credit for a student's participation in the study tour program. The revenue ruling concludes that the organization furthers educational purposes because it performs training and instruction for the purpose of allowing individuals to improve and develop their capabilities, and is, therefore, described in section 501(c)(3).

Rev. Rul. 77–366, 1977–2 C.B. 192, concerns an organization that arranges and conducts ocean cruises for ministers, church members and their families for the purpose of providing continuing education in an atmosphere supporting spiritual renewal. The organization's activities include lectures, discussions, workshops and some shore activities that further charitable purposes. However, because of the extensive resources the organization devotes to social and recreational programs, the scheduling of those programs relative to the schedule for the exempt purpose programs, and other facts and circumstances, the organization was held to be also serving a substantial nonexempt purpose and, therefore, not to qualify for exemption as an organization described in section 501(c)(3).

The Tax Court applied a similar analysis to an organization operating a mountain lodge when it held that the organization failed to qualify as a religious organization described in section 501(c)(3). Although religious activities were offered to guests in addition to a wide range of recreational activities, guests were not required to participate in the religious activities, and the record failed to show that the recreational activities were insubstantial. See *The Schoger Foundation v. Commissioner,* 76 T.C. 380 (1981).

In contrast, Rev. Rul. 77–430, 1977–2 C.B. 194, holds that an organization conducting weekend retreats is furthering its stated purpose of advancing religion. Individuals come to participate in a program of seminars, lectures, prayer sessions and meditation led by ministers and priests that are scheduled on an hourly basis throughout the day. Recreational activities are not scheduled, but are available to participants during their limited free time. Under these facts and circumstances, the ruling holds that the facilities are being used to advance religion and that recreational activities are incidental to the accomplishment of this purpose.

The revenue rulings all focus on the degree of educational or religious content participants are expected to receive in each travel program in determining whether the activity serves an exempt purpose. The same approach was taken in the one ruling that has specifically addressed the application of the unrelated business income tax to income generated by travel tours. Rev. Rul. 78–43, 1978–1 C.B. 164, describes the travel tour activity of a university alumni association. The association's program of approximately ten tours per year is open to all current members and their immediate families and is planned with various travel agencies. Each travel agency pays a per person fee to the association. The tours do not include any formal educational program and do not differ substantially from commercially operated tours. Rev. Rul. 78–43 concludes that there is no causal relationship between arranging the travel tours described in the ruling and the achievement of an exempt purpose. Accordingly, the ruling holds that the sale of tours to members is an unrelated trade or business within the meaning of section 513.

These proposed regulations are intended to augment the guidance that currently exists with respect to travel tours and the unrelated business income tax. The proposed regulations also provide additional guidance regarding the fragmentation rule and the distinctions that may be necessary among different tours or activities that are part of a single organization's travel program.

The IRS and Treasury are soliciting comments on these proposed regulations. In particular, because the IRS relies heavily on review of records to determine whether an organization's trade or business activities further an exempt purpose, comments are requested on whether the IRS should specify the types of records organizations should keep to establish the activity's purpose.

Explanation of Provisions

The proposed regulations add a new §1.513–7 providing that the determination of whether travel tour activities of tax exempt organizations are substantially related to an organization's exempt purposes is a question of facts and circumstances. The proposed regulations set forth a series of examples to illustrate how various facts and circumstances would be analyzed.

Proposed Effective Date

These regulations are proposed to be effective for taxable years beginning after the date final regulations are published in the **Federal Register.** For prior taxable years, the IRS will continue to apply principles of existing law.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in EO 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and because the regulation does not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Internal Revenue Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Requests for a Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written comments (a signed original and eight (8) copies) that are submitted timely to the IRS. All comments will be available for public inspection and copying. A public hearing may be scheduled if requested in writing by a person that timely submits written comments. If a public hearing is scheduled, notice of the date, time, and place for the hearing will be published in the **Federal Register.**

Drafting Information

The principal author of these regulations is Robin Ehrenberg, Office of Associate Chief Counsel (Employee Benefits and Exempt Organizations). However, other personnel from the IRS and Treasury Department participated in their development.

Proposed Amendments to the Regulations

Accordingly, 26 CFR part 1 is proposed to be amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 2. Section 1.513–7 is added to read as follows:

§ 1.513-7 Travel and tour activities of tax exempt organizations.

(a) Travel tour activities that constitute a trade or business, as defined in § 1.513-1(b), and that are not substantially related to the purposes for which exemption has been granted to the organization constitute an unrelated trade or business with respect to that organization. Whether travel tour activities conducted by an organization are substantially related to the organization's exempt purpose is determined by looking at all relevant facts and circumstances. Section 513(c) and § 1.513–1(b) also apply to travel tour activity. Application of the rules of section 513(c) and § 1.513–1(b) may result in different treatment for individual tours within an organization's travel tour program.

(b) *Examples.* The provisions of this section are illustrated by the following examples:

Example 1. O, a university alumni association, is exempt from federal income tax under section 501(a) as an educational organization described in section 501(c)(3). As part of its activities, O operates a travel tour program. The program is open to all current members of O and their guests. O works with travel agencies to schedule approximately 10 tours annually to various destinations around the world. Members of O pay $X to the organizing travel agency to participate in a tour. The travel agency pays O a per person fee for each participant. Although the literature advertising the tours encourages O's members to continue their lifelong learning by joining the tours, and a faculty member of O's related university is invited to join the tour as a guest of the alumni association, none of the tours includes any scheduled instruction or curriculum related to the destinations being visited. By arranging to make travel tours available to its members, O is not contributing importantly to the accomplishment of its educational purpose. Rather, O's program is designed to generate revenues for O by regularly offering its members travel services. Accordingly, O's tour program is an unrelated trade or business within the meaning of section 513(a) of the Code.

Example 2. N is an organization formed for the purpose of educating individuals about the geography and culture of the United States. It is exempt from federal income tax under section 501(a) as an educational and cultural organization described in section 501(c)(3). N engages in a number of activities to accomplish its purposes, including offering courses and publishing periodicals and books. As one of its activities, N conducts study tours to national parks and other locations within the United States. The study tours are conducted by teachers and other education professionals. The tours are open to all who agree to participate in the required study program. The study program consists of community college level courses related to the location being visited by the tour. While the students are on the tour, five or six hours per day are devoted to organized study, preparation of reports, lectures, instruction and recitation by the students. Each tour group brings along a library of material related to the subject being studied on the tour. Examinations are given at the end of each tour and N's state board of education awards academic credit for tour participation. Because the tours offered by N include a substantial amount of required study, lectures, report preparation, examinations and qualify for academic credit, the tours clearly further N's educational purpose. Accordingly, N's tour program is not an unrelated trade or business within the meaning of section 513(a) of the Code.

Example 3. R is a section 501(c)(4) social welfare organization devoted to advocacy on a particular issue. On a regular basis throughout the year, R organizes a travel tour for its members to Washington, D.C.. The tours are priced to produce a profit for R. While in Washington, the members follow a schedule according to which they spend substantially all of their time over several days attending meetings with legislators and government officials and receiving briefings on policy developments related to the issue that is R's focus. Bringing members to Washington to participate in advocacy on behalf of the organization and learn about developments relating to the organization's principal focus is substantially related to R's social welfare purpose. Therefore, R's operation of the travel tours does not constitute an unrelated trade or business.

Example 4. S is a membership organization formed to foster cultural unity and to educate X Americans about X, their country of origin. It is exempt from federal income tax under section 501(a) and is described in section 501(c)(3) as an educational and cultural organization. Membership in S is open to all Americans interested in the X heritage. As part of its activities, S sponsors a program of travel tours to X. All of S's tours are priced to produce a profit for S. The tours are divided into two categories. Category A tours are trips to X that are designed to immerse participants in the X history, culture and language. The itinerary is designed to have participants spend substantially all of their time while in X receiving instruction on the X language, history and cultural heritage. Destinations are selected because of their historical or cultural significance or because of instructional resources they offer. Category B tours are also trips to X, but rather than offering scheduled instruction, participants are given the option of taking guided tours of various X locations included in their itinerary. Other than the optional guided tours, Category B tours offer no instruction or curriculum. Even if participants take all of the tours offered, they have a substantial amount of time free to pursue their own interests once in X. Destinations of principally recreational interest, rather than historical or cultural interest, are regularly included on Category B tour itineraries. Based on the facts and circumstances, sponsoring Category A tours is an activity substantially related to S's exempt purposes, and does not constitute an unrelated trade or business with respect to S. However, sponsoring Category B tours does not contribute importantly to S's accomplishment of its exempt purposes and is designed to generate a profit for S. Therefore, sponsoring the Category B tours constitutes an unrelated trade or business with respect to S.

Michael P. Dolan,
Deputy Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on April 20, 1998, 2:48 p.m., and published in the issue of the Federal Register for April 23, 1998, 63 F.R. 20156)

Notice of Proposed Rulemaking

S Corporation Subsidiaries

REG–251698–96

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains proposed regulations relating to the treatment of corporate subsidiaries of S corporations. The proposed regulations interpret the rules added to the Internal Revenue Code by section 1308 of the Small Business Job Protection Act of 1996. The proposed regulations affect S corporations and their subsidiaries.

DATES: Written comments must be received by July 21, 1998.

ADDRESSES: Send submissions to CC:DOM:CORP:R (REG–251698–96), room 5228, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered between the hours of 8 a.m. and 5 p.m. to: CC:DOM:CORP:R (REG–251698–96), Courier's Desk, In-

ternal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC. Alternatively, taxpayers may submit comments electronically via the Internet by selecting the "Tax Regs" option on the IRS Home Page, or by submitting comments directly to the IRS Internet site at http://www.irs.ustreas.gov/prod/tax_regs/comments.html.

FOR FURTHER INFORMATION CONTACT: Concerning the regulations, Deanna L. Walton, (202) 622-3050 (Subchapter S) or Lee A. Dean, (202) 622-7540 (Subchapter C); concerning submissions, Michael Slaughter, (202) 622-7190 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collections of information contained in this notice of proposed rulemaking have been submitted to the **Office of Management and Budget** for review in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)).

Comments on the collections of information should be sent to the **Office of Management and Budget,** Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503, with copies to the **Internal Revenue Service,** Attn: IRS Reports Clearance Officer, T:FP, Washington, DC 20224. Comments on the collections of information should be received by June 22, 1998. Comments are specifically requested concerning:

Whether the proposed collections of information are necessary for the proper performance of the functions of the Internal Revenue Service, including whether the collections will have a practical utility;

The accuracy of the estimated burden associated with the proposed collections of information (see below);

How the quality, utility, and clarity of the information to be collected may be enhanced;

How the burden of complying with the proposed collections of information may be minimized, including through the application of automated collection techniques or other forms of information technology; and

Estimates of capital or start-up costs and costs of operation, maintenance, and purchase of services to provide information.

The collections of information in these proposed regulations are in §§1.1361–3(a)(1), 1.1361–3(b)(1), 1.1361–5(a)(2), and 1.1362–8. The collections of information are required to determine the manner in which a corporate subsidiary of an S corporation will be treated under the Internal Revenue Code.

These collections of information are required to obtain a benefit. The likely respondents and/or recordkeepers are small businesses or organizations, businesses or other for-profit institutions, and farms.
Estimated total annual reporting/recordkeeping burden: 10,110 hours
Estimated average annual burden per respondent/recordkeeper: 57 minutes
Estimated number of respondents/recordkeepers: 10,660
Estimated annual frequency of responses: On occasion

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a valid control number assigned by the Office of Management and Budget.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

Background

This document contains proposed amendments to the Income Tax Regulations (26 CFR Part 1) relating to S corporations and their subsidiaries under sections 1361 and 1362 of the Internal Revenue Code (Code). Section 1308 of the Small Business Job Protection Act of 1996, Public Law 104–188, 110 Stat. 1755 (the Act), modified section 1361 of the Code to permit an S corporation (1) to own 80 percent or more of the stock of a C corporation, and (2) to elect to treat a wholly owned subsidiary as a qualified subchapter S subsidiary (QSSS). In Notice 97–4 (1997–2 I.R.B. 24), the IRS announced its intention to issue regulations under section 1308 of the Act and requested comments on certain issues. Section 1601 of the Taxpayer Relief Act of 1997, Public Law 105–34, 111 Stat. 788 (the 1997 Act), made a technical correction to section 1361 to provide regulatory authority regarding the consequences of an election to be a QSSS.

Explanation of Provisions

Overview

Prior law prohibited an S corporation from owning 80 percent or more of the stock of another corporation. The Act repealed section 1362(b)(2)(A) of the Internal Revenue Code (Code), thereby allowing an S corporation to own 80 percent or more of the stock of a C corporation. The Act also added section 1504(b)(8) to the Code to prevent an S corporation from joining in the filing of a consolidated return with its affiliated C corporations. A C corporation subsidiary of an S corporation, however, may file a consolidated return with its affiliated C corporations. See H.R. Conf. Rep. No. 737, 104th Cong., 2d Sess. 224 (1996).

New section 1361(b)(3)(B) defines the term qualified subchapter S subsidiary as any domestic corporation that is not an ineligible corporation if, (1) an S corporation holds 100 percent of the stock of the corporation, and (2) that S corporation elects to treat the subsidiary as a QSSS. Except as otherwise provided in regulations, a corporation for which a QSSS election is made is not treated as a separate corporation, and all assets, liabilities, and items of income, deduction, and credit of the QSSS are treated as assets, liabilities, and items of income, deduction, and credit of the parent S corporation. The legislative history accompanying section 1361(b)(3) indicates that, when the parent corporation makes the election, the subsidiary is deemed to have liquidated under sections 332 and 337 immediately before the election is effective. See S. Rep. No. 281, 104th Cong., 2d Sess. 53 (1996); H.R. Rep. No. 586, 104th Cong., 2d Sess. 89 (1996). However, the legislative history accompanying the technical correction made by the 1997 Act indicates that regulations may provide exceptions to that general rule. See S. Rep. No. 33, 105th Cong., 1st Sess. 320 (1997).

Section 1361(b)(3)(C) provides that any QSSS that ceases to meet the requirements of section 1361(b)(3)(B) will be treated as a new corporation acquiring all of its assets (and assuming all of its liabilities) immediately before the cessation from its S corporation parent in exchange

for the subsidiary's stock. Section 1361(b)(3)(D) provides that a QSSS whose election has terminated (or a successor corporation) may not make an S election or have a QSSS election made with respect to it before its fifth taxable year that begins after the first taxable year for which the termination is effective, unless the Secretary consents to the election.

Under current and prior law, the S election of a corporation with subchapter C corporation earnings and profits terminated if that S corporation received passive investment income, including dividends, in excess of 25 percent of gross receipts for three consecutive years. Section 1362(d)(3)(E) modifies that general rule by excluding dividends from passive investment income to the extent that the dividends are attributable to the active conduct of a trade or business of a C corporation in which the S corporation has an 80 percent or greater ownership interest. Neither the Act nor the legislative history provides rules for determining the attribution of dividends to an active trade or business.

QSSS Formation

Under the proposed regulations, an S corporation makes a QSSS election with respect to an eligible subsidiary by filing a form to be developed by the IRS prior to the time these regulations become final. This proposes to change the temporary election procedure provided in Notice 97–4, which provides that a parent S corporation files a completed Form 966, Corporate Dissolution and Liquidation (with some modifications), to make a QSSS election. Until these proposed regulations are finalized, taxpayers should continue to use the temporary election procedure in Notice 97–4 to make QSSS elections.

The proposed regulations also provide that the effective date of a QSSS election may be up to 2 months and 15 days prior to the day the QSSS election is made. This is a slight change from the 75 day retroactive period provided in Notice 97–4, but is consistent with the general time period for making S elections. Unlike the S election, however, a QSSS election does not need to be made within 2 months and 15 days of the beginning of a taxable year. A similar retroactive period is provided for revocations of QSSS status. In addition, a taxpayer may choose a prospective effective date for a QSSS election or revocation, so long as the date selected is not more than 12 months after the date the election or revocation is made.

The proposed regulations provide that, when an S corporation makes a valid QSSS election with respect to a subsidiary, the subsidiary is deemed to have liquidated into the parent. The tax treatment of this liquidation, alone or in the context of any larger transaction (for example, a transaction that also includes the acquisition of the subsidiary's stock), is generally determined under all relevant provisions of the Code and general principles of tax law, including the step transaction doctrine. However, a special transition rule applies to certain elections effective prior to the date that is 60 days after publication of final regulations in the **Federal Register.** The transition rule indicates the recognition of special concerns that may have arisen as a result of transactions entered into by taxpayers relying on the legislative history to the Act and without applying the step transaction doctrine to the acquisition of the subsidiary's stock followed by a QSSS election. The IRS requests comments concerning other transactions occurring during the transitional period for which relief from the effect of application of the step transaction doctrine may be warranted.

Special rules may apply when a QSSS election is made following the transfer of one S corporation's stock to another S corporation. For example, if an S corporation acquires the stock of another S corporation in a transaction in which the acquiring S corporation's basis in the stock received is determined by reference to the transferor's basis and makes a QSSS election with respect to the other corporation effective on the day of acquisition, any losses disallowed under section 1366(d) with respect to a former shareholder of the QSSS will be available to that shareholder as a shareholder of the acquiring S corporation. Furthermore, when stock in an S corporation is transferred to another S corporation and a QSSS election is made with respect to the subsidiary effective on the day of acquisition, the S election of the former corporation terminates at the same moment as the QSSS election becomes effective. This rule ensures that the former S corporation is not treated as a C corporation for any period solely because of the transfer.

Generally, the proposed regulations treat the liquidation as occurring at the close of the day before the QSSS election is effective. Under this rule, if a parent corporation makes an S election effective on the same date as a QSSS election with respect to a subsidiary, the deemed liquidation occurs at a time when the parent corporation is still a C corporation. A QSSS election satisfies the requirement of adopting a plan of liquidation under section 332.

Following the deemed liquidation, the QSSS is not treated as a separate corporation (except as otherwise provided in the regulations), and all assets, liabilities, and items of income, deduction, and credit are treated as those of the S corporation. Accordingly, all such items must be reported on the S corporation's return required to be filed under section 6037. A special rule applies for the calculation of these items where either an S corporation or its QSSS is a bank (as defined in section 581). This special rule was first announced in Notice 97–5 (1997–2 I.R.B. 25). Until these proposed regulations are finalized, taxpayers should continue to follow Notice 97–5.

QSSS Termination

The QSSS status of a corporation continues until it terminates. The regulations specify the date of termination for specific terminating events. Section 1361(b)(3)(D) provides that, if a QSSS election terminates, the corporation is treated as a new corporation acquiring all of its assets (and assuming all of its liabilities) from the S corporation in exchange for stock of the new corporation immediately before the termination. The tax treatment of this transaction or of a larger transaction that includes this transaction will be determined under the Code and general principles of tax law, including the step transaction doctrine. Examples are provided to illustrate situations in which the formation of the new corporation will qualify as a nonrecognition transaction under section 351. The proposed regulations also provide that, under certain circumstances, relief may be available under the standards established under section 1362(f) for the inadvertent termination of an S election.

Section 1361(b)(3)(D) provides that a corporation whose QSSS election has terminated (or a successor corporation) may not make an S election or have a QSSS election made with respect to it for five taxable years following the termination without the consent of the Secretary. The proposed regulations provide that, without requesting the Secretary's consent, a corporation may make an election to be treated as an S corporation or may have a QSSS election made with respect to it before the expiration of the five-year period under certain circumstances. Consent is not required if an otherwise valid S election or QSSS election is made for the former QSSS (or its successor corporation) effective immediately following the disposition of its stock. Thus, the proposed regulations allow corporations to move freely between QSSS and S corporation status, provided there is no intervening period for which the corporation is treated as a C corporation.

C Corporation Subsidiaries

The proposed regulations also provide rules relating to certain C corporation subsidiaries held by S corporations. Under section 1362(d)(3)(E), dividends received by an S corporation from a C corporation in which the S corporation has an 80 percent or greater ownership interest are not treated as passive investment income for purposes of sections 1362 and 1375 to the extent the dividends are attributable to the earnings and profits of the C corporation derived from the active conduct of a trade or business. The proposed regulations provide guidance for attributing dividends to the active conduct of a trade or business. Special rules apply to dividends distributed by the common parent of a consolidated group.

Under the proposed regulations, earnings and profits of a C corporation derived from the active conduct of a trade or business are the earnings and profits of the corporation derived from activities that would not produce passive investment income under section 1362(d)(3) if the C corporation were an S corporation. The proposed regulations provide a safe harbor under which the corporation may determine the amount of the active earnings and profits by comparing the corporation's gross receipts derived from nonpassive investment income-producing activities with the corporation's total gross receipts in the year the earnings and profits are produced. If less than 10 percent of the C corporation's earnings and profits for a taxable year are derived from activities that would produce passive investment income, all earnings and profits produced by the corporation during the taxable year are considered active earnings and profits.

The proposed regulations also provide that a C corporation may treat all earnings and profits accumulated by the corporation prior to the time an S corporation held stock meeting the requirements of section 1504(a)(2) as active earnings and profits in the same proportion as the C corporation's active earnings and profits for the three taxable years ending prior to the time when the S corporation acquired 80 percent of the C corporation bear to the C corporation's total earnings and profits for those three taxable years. Provisions also address the allocation of distributions from current or accumulated earnings and profits.

Proposed Effective Date

The regulations are proposed to be effective on the date that final regulations are published in the **Federal Register.** However, the IRS is considering whether certain provisions should be made retroactive. The IRS requests comments concerning whether certain provisions should be made effective for taxable years beginning on or after January 1, 1997.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in EO 12866. Therefore, a regulatory assessment is not required. Pursuant to section 7805(f) of the Internal Revenue Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business. It is hereby certified that the collections of information contained in these regulations will not have a significant economic impact on a substantial number of small businesses. This certification is based on the fact that the economic burden imposed on taxpayers by the collections of information and recordkeeping requirements of these regulations is insignificant. For example, the estimated average annual burden per respondent is less than one hour. Furthermore, most taxpayers will only have to respond to the requests for information contained in §§1.1361–3(b)(1) and 1.1361–5(a)(2) one time in the life of the corporation. Therefore, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required.

Comments and Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written comments (preferably a signed original and eight (8) copies) that are timely submitted to the IRS. All comments will be available for public inspection and copying.

A public hearing will be scheduled in the Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC. The IRS recognizes that persons outside the Washington, DC, area also may wish to testify at the public hearing through teleconferencing. Requests to include teleconferencing sites must be received by June 22, 1998. If the IRS receives sufficient indications of interest to warrant teleconferencing to a particular city, and if the IRS has teleconferencing facilities available in that city on the date the public hearing is to be scheduled, the IRS will try to accommodate the requests.

The IRS will publish the time and date of the public hearing and the locations of any teleconferencing sites in an announcement in the **Federal Register.**

Drafting Information

The principal authors of these proposed regulations are Deanna L. Walton, Office of the Assistant Chief Counsel (Passthroughs and Special Industries); and Lee A. Dean, Office of the Assistant Chief Counsel (Corporate). However, other personnel from the IRS and Treasury Department participated in their development.

Proposed Amendments to the Regulations

Accordingly, 26 CFR part 1 is proposed to be amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 2. Amend §1.1361–0 as follows:

1. Revise the introductory text.

2. Remove the entry for §1.1361–1(d)(3).

3. Add entries for §§1.1361–2, 1.1361–3, 1.1361–4, 1.1361–5, and 1.1361–6.

The revisions and additions read as follows:

§1.1361–0 Table of contents.

This section lists captions contained in §§1.1361–1, 1.1361–2, 1.1361–3, 1.1361–4, 1.1361–5, and 1.1361–6.

* * * * *

§1.1361–2 Definitions relating to S corporation subsidiaries.

(a) In general.
(b) Stock treated as held by S corporation.
(c) Examples.

§1.1361–3 QSSS election.

(a) Time and manner of making election.
(1) In general.
(2) Time of making election.
(3) Effective date of election.
(4) Example.
(5) Extension of time for making a QSSS election.
(b) Revocation of QSSS election.
(1) Manner of revoking QSSS election.
(2) Effective date of revocation.
(3) Revocation after termination.

§1.1361–4 Effect of QSSS election.

(a) Separate existence ignored.
(1) In general.
(2) Liquidation of subsidiary.
(3) Treatment of banks.
(i) In general.
(ii) Examples.
(4) Treatment of stock of QSSS.
(5) Transitional relief.
(i) General rule.
(ii) Examples.
(b) Timing of the liquidation.
(1) In general.
(2) Acquisitions.
(3) Coordination with section 338 election.
(c) Carryover of disallowed losses and deductions.
(d) Examples.

§1.1361–5 Termination of QSSS election.

(a) In general.
(1) Effective date.
(2) Information to be provided upon termination of QSSS election by failure to qualify as a QSSS.
(3) Examples.
(b) Effect of termination of QSSS election.
(1) Formation of new corporation.
(2) Carryover of disallowed losses and deductions.
(3) Examples.
(c) Inadvertent terminations.
(d) Election after QSSS termination.
(1) In general.
(2) Exception.
(3) Examples.

§1.1361–6 Effective date.

Par. 3. Amend §1.1361–1 as follows:

1. Revise paragraph (b)(1)(i).

2. Remove paragraph (d)(1)(i).

3. Redesignate paragraphs (d)(1)(ii), (d)(1)(iii), (d)(1)(iv), and (d)(1)(v) as paragraphs (d)(1)(i), (d)(1)(ii), (d)(1)(iii), and (d)(1)(iv), respectively.

4. Revise newly designated paragraph (d)(1)(i).

5. Remove paragraph (d)(3).

6. Revise the first sentence of paragraph (e)(1).

The revisions read as follows:

§1.1361–1 S corporation defined.

* * * * *

(b) * * *

(1) * * *

(i) More than 75 shareholders (35 for taxable years beginning before January 1, 1997);

* * * * *

(d) * * *

(1) * * *

(i) For taxable years beginning on or after January 1, 1997, a financial institution that uses the reserve method of accounting for bad debts described in section 585 (for taxable years beginning prior to January 1, 1997, a financial institution to which section 585 applies (or would apply but for section 585(c)) or to which section 593 applies);

* * * * *

(e) * * *

(1) *General rule.* A corporation does not qualify as a small business corporation if it has more than 75 shareholders (35 for taxable years beginning prior to January 1, 1997). * * *

* * * * *

Par. 4. Add §§ 1.1361–2, 1.1361–3, 1.1361–4, 1.1361–5, and 1.1361–6 to read as follows:

§1.1361–2 Definitions relating to S corporation subsidiaries.

(a) *In general.* The term *qualified subchapter S subsidiary* (QSSS) means any domestic corporation that is not an ineligible corporation (as defined in section 1361(b)(2) and the regulations thereunder), if—

(1) 100 percent of the stock of such corporation is held by an S corporation; and

(2) The S corporation properly elects to treat the subsidiary as a QSSS under §1.1361–3.

(b) *Stock treated as held by S corporation.* For purposes of satisfying the 100 percent stock ownership requirement in section 1361(b)(3)(B)(i) and paragraph (a)(1) of this section, stock of a corporation is treated as held by an S corporation if the S corporation is the owner of that stock for federal income tax purposes.

(c) *Examples.* The following examples illustrate the application of this section:

Example 1. *X*, an S corporation, owns 100 percent of *Y*, a corporation for which a valid QSSS election is in effect for the taxable year. *Y* owns 100 percent of *Z*, a corporation otherwise eligible for QSSS status. *X* may elect to treat *Z* as a QSSS under section 1361(b)(3)(B)(ii).

Example 2. Assume the same facts as in *Example 1*, except that *Y* is a business entity that is disregarded as an entity separate from its owner under §301.7701–2(c)(2) of this chapter. *X* may elect to treat *Z* as a QSSS.

Example 3. Assume the same facts as in *Example 1*, except that *Y* owns 50 percent of *Z*, and *X* owns the other 50 percent. *X* may elect to treat *Z* as a QSSS.

Example 4. Assume the same facts as in *Example 1*, except that *Y* is a C corporation. Although *Y* is a domestic corporation that is otherwise eligible to be a QSSS, no QSSS election has been made for *Y*. Thus, *X* is not treated as holding the stock of *Z*. Consequently, *X* may not elect to treat *Z* as a QSSS.

§1.1361–3 QSSS election.

(a) *Time and manner of making election*—(1) *In general.* Except as provided

in section 1361(b)(3)(D) and §1.1361–5(d) (five-year prohibition on re-election), an S corporation may elect to treat an eligible subsidiary as a QSSS by filing a completed form to be prescribed by the Internal Revenue Service. The election form must be signed by a person authorized to sign the S corporation's return required to be filed under section 6037 and must be submitted to the service center where the subsidiary filed its most recent tax return (if applicable). If an S corporation forms a subsidiary and makes a valid QSSS election (effective upon the date of the subsidiary's formation) for the subsidiary, the election should be submitted to the service center where the S corporation filed its most recent return.

(2) *Time of making election.* A QSSS election may be made by the S corporation parent at any time during the taxable year.

(3) *Effective date of election.* A QSSS election will be effective on the date specified on the election form or on the date the election form is filed if no date is specified. The effective date specified on the form can not be more than 2 months and 15 days prior to the date of filing and can not be more than 12 months after the date of filing. For this purpose, the definition of the term "month" found in §1.1362–6(a)(2)(ii)(C) applies. If an election form specifies an effective date more than 2 months and 15 days prior to the date on which the election form is filed, it will be effective 2 months and 15 days prior to the date it is filed. If an election form specifies an effective date more than 12 months after the date on which the election is filed, it will be effective 12 months after the date it is filed. The corporation for which the QSSS election is made must meet all the requirements of section 1361(b)(3)(B) at the time the election is made and for all periods for which the election is to be effective.

(4) *Example.* The following example illustrates the application of paragraph (a)(3) of this section:

Example. X has been a calendar year S corporation engaged in a trade or business for several years. *X* acquires the stock of *Y*, a calendar year C corporation, on April 1, 1998. On August 10, 1998, *X* makes an election to treat *Y* as a QSSS. Unless otherwise specified on the election form, the election will be effective as of August 10, 1998. If specified on the election form, the election may be effective on some other date that is not more than 2 months and 15 days prior to August 10, 1998, and not more than 12 months after August 10, 1998.

(5) *Extension of time for making a QSSS election.* An extension of time to make a QSSS election may be available under the procedures applicable under §§301.9100–1 and 301.9100–3 of this chapter.

(b) *Revocation of QSSS election*—(1) *Manner of revoking QSSS election.* An S corporation may revoke a QSSS election under section 1361 by filing a statement with the service center where the S corporation's most recent tax return was properly filed. The revocation statement must include the names, addresses, and taxpayer identification numbers of both the parent S corporation and the QSSS. The statement must be signed by a person authorized to sign the S corporation's return required to be filed under section 6037.

(2) *Effective date of revocation.* The revocation of a QSSS election is effective on the date specified on the revocation statement or on the date the revocation statement is filed if no date is specified. The effective date specified on the revocation statement can not be more than 2 months and 15 days prior to the date on which the revocation statement is filed and can not be more than 12 months after the date on which the revocation statement is filed. If a revocation statement specifies an effective date more than 2 months and 15 days prior to the date on which the statement is filed, it will be effective 2 months and 15 days prior to the date it is filed. If a revocation statement specifies an effective date more than 12 months after the date on which the statement is filed, it will be effective 12 months after the date it is filed.

(3) *Revocation after termination.* A revocation may not be made after the occurrence of an event that renders the subsidiary ineligible for QSSS status under section 1361(b)(3)(B).

§1.1361–4 Effect of QSSS election.

(a) *Separate existence ignored*—(1) *In general.* Except as otherwise provided in paragraph (a)(3) of this section, for federal tax purposes—

(i) A corporation which is a QSSS shall not be treated as a separate corporation; and

(ii) All assets, liabilities, and items of income, deduction, and credit of a QSSS shall be treated as assets, liabilities, and items of income, deduction, and credit of the S corporation.

(2) *Liquidation of subsidiary.* If an S corporation makes a valid QSSS election with respect to a subsidiary, the subsidiary is deemed to have liquidated into the S corporation. Except as provided in paragraph (a)(5) of this section, the tax treatment of the liquidation or of a larger transaction that includes the liquidation will be determined under the Internal Revenue Code and general principles of tax law, including the step transaction doctrine. Thus, for example, if an S corporation forms a subsidiary and makes a valid QSSS election (effective upon the date of the subsidiary's formation) for the subsidiary, there will be no deemed liquidation of the new subsidiary. Instead, the corporation will be deemed to be a QSSS from its inception. For purposes of section 332, the making of a QSSS election satisfies the requirement of adopting a plan of liquidation.

(3) *Treatment of banks*—(i) *In general.* If an S corporation is a bank, or if an S corporation makes a valid QSSS election for a subsidiary that is a bank, any special rules applicable to banks under the Internal Revenue Code continue to apply separately to the bank parent or bank subsidiary as if the deemed liquidation of any QSSS under paragraph (a)(2) of this section had not occurred. For any QSSS that is a bank, however, all assets, liabilities, and items of income, deduction, and credit of the QSSS, as determined in accordance with the special bank rules, are treated as assets, liabilities, and items of income, deduction, and credit of the S corporation. For purposes of this paragraph (a)(3)(i), the term "bank" has the same meaning as in section 581.

(ii) *Examples.* The following examples illustrate the application of this paragraph (a)(3):

Example 1. X, an S corporation, is a bank as defined in section 581. *X* owns 100 percent of *Y* and *Z*, corporations for which valid QSSS elections are in effect. *Y* is a bank as defined in section 581, and *Z* is not a financial institution. Pursuant to paragraph (a)(3)(i) of this section, any special rules applicable to banks under the Internal Revenue Code continue to apply separately to *X* and *Y* and do not apply to *Z*. Thus, for example, section 265(b), which provides special rules for interest expense deductions of banks, applies separately to *X* and *Y*. That is, *X* and *Y* each must make a separate determination under section 265(b) of interest expense allocable to tax-

exempt interest, and no deduction is allowed for that interest expense.

Example 2. *X*, an S corporation, is a bank holding company and thus is not a bank as defined in section 581. *X* owns 100 percent of *Y*, a corporation for which a valid QSSS election is in effect. *Y* is a bank as defined in section 581. Pursuant to paragraph (a)(3)(i) of this section, any special rules applicable to banks under the Internal Revenue Code continue to apply to Y and do not apply to *X*. However, all of *Y*'s assets, liabilities, and items of income, deduction, and credit, as determined in accordance with the special bank rules, are treated as those of *X*. Thus, for example, section 582(c), which provides special rules for sales and exchanges of debt by banks, applies only to sales and exchanges by Y. However, any gain or loss on such a transaction by Y that is considered ordinary income or ordinary loss pursuant to section 582(c) is treated as ordinary income or ordinary loss of *X*.

(4) *Treatment of stock of QSSS.* Except for purposes of section 1361(b)(3)(B)(i) and §1.1361–2(a)(1), the stock of a QSSS shall be disregarded for all federal tax purposes.

(5) *Transitional relief*—(i) *General rule.* If an S corporation and another corporation (the related corporation) are persons specified in section 267(b) prior to an acquisition by the S corporation of some or all of the stock of the related corporation followed by a QSSS election for the related corporation, the step transaction doctrine will not apply to determine the tax consequences of the acquisition. This paragraph (a)(5) shall apply to QSSS elections effective prior to the date that is 60 days after publication of final regulations in the **Federal Register.**

(ii) *Examples.* The following examples illustrate the application of this paragraph (a)(5):

Example 1. Individual *A* owns 100 percent of the stock of *X*, an S corporation. *X* owns 79 percent of the stock of *Y*, a solvent corporation, and *A* owns the remaining 21 percent. On May 4, 1998, *A* contributes its *Y* stock to *X* in exchange for *X* stock. *X* makes a QSSS election with respect to *Y* effective immediately following the transfer. The liquidation described in paragraph (a)(2) of this section is respected as an independent step separate from the stock acquisition, and the tax consequences of the liquidation are determined under sections 332 and 337. The contribution by *A* of the *Y* stock qualifies under section 351, and no gain or loss is recognized by *A*, *X*, or *Y*.

Example 2. Individual *A* owns 100 percent of the stock of two solvent S corporations, *X* and *Y*. On May 4, 1998, *A* contributes the stock of *Y* to *X*. *X* makes a QSSS election with respect to *Y* immediately following the transfer. The liquidation described in paragraph (a)(2) of this section is respected as an independent step separate from the stock acquisition, and the tax consequences of the liquidation are determined under sections 332 and 337. The contribution by *A* of the *Y* stock to *X* qualifies under section 351, and no gain or loss is recognized by *A*, *X*, or *Y*. *Y* is not treated as a C corporation for any period solely because of the transfer of its stock to *X*, an ineligible shareholder. See §1.1362–2(b)(4).

(b) *Timing of the liquidation*—(1) *In general.* Except as otherwise provided in paragraphs (b)(2) or (b)(3) of this section, the liquidation described in paragraph (a)(2) of this section occurs at the close of the day before the QSSS election is effective. Thus, for example, if a C corporation elects to be treated as an S corporation and makes a QSSS election (effective the same date as the S election) with respect to a subsidiary, the liquidation occurs immediately before the S election becomes effective, while the S electing parent is still a C corporation.

(2) *Acquisitions.* If an S corporation does not own 100 percent of the stock of the subsidiary on the day before the QSSS election is effective, the liquidation described in paragraph (a)(2) of this section occurs immediately after the time at which the S corporation first owns 100 percent of the stock.

(3) *Coordination with section 338 election.* An S corporation that makes a qualified stock purchase of a target may make an election under section 338 with respect to the acquisition if it meets the requirements for the election, and may make a QSSS election with respect to the target. If an S corporation makes an election under section 338 with respect to a subsidiary acquired in a qualified stock purchase, a QSSS election made with respect to that subsidiary is not effective before the day after the acquisition date (within the meaning of section 338(h)(2)). If the QSSS election is effective on the day after the acquisition date, the liquidation under paragraph (a)(2) of this section occurs immediately after the deemed asset purchase by the new target corporation under section 338. If an S corporation makes an election under section 338 (without a section 338(h)(10) election) with respect to a target, the target must file a final or deemed sale return as a C corporation reflecting the deemed sale. See §1.338–1(e).

(c) *Carryover of disallowed losses and deductions.* If an S corporation (S1) acquires the stock of another S corporation (S2) in a transaction in which the basis of the S2 stock is determined in whole or in part by reference to the transferor's basis, and S1 makes a QSSS election with respect to S2 effective on the day of the acquisition, any loss or deduction disallowed under section 1366(d) with respect to a former shareholder of S2 is available to that shareholder as a shareholder of S1. Thus, a loss or deduction of a shareholder of S2 disallowed prior to or during the taxable year of the transaction is treated as incurred by S1 with respect to that shareholder if the shareholder is a shareholder of S1 after the transaction.

(d) *Examples.* The following examples illustrate the application of this section:

Example 1. *X*, an S corporation, owns 100 percent of the stock of *Y*, a C corporation. On June 2, 1998, *X* makes a valid QSSS election for *Y*, effective June 2, 1998. Assume that, under general principles of tax law, including the step transaction doctrine, *X*'s acquisition of the *Y* stock and the subsequent QSSS election would not be treated as related. The liquidation described in paragraph (a)(2) of this section occurs at the close of the day on June 1, 1998, the day before the QSSS election is effective, and the plan of liquidation is considered adopted on that date. *Y*'s taxable year and separate existence for federal tax purposes end at the close of June 1, 1998.

Example 2. *X*, a C corporation, owns 100 percent of the stock of *Y*, another C corporation. On December 31, 1998, *X* makes an election under section 1362 to be treated as an S corporation and a valid QSSS election for *Y*, both effective January 1, 1999. Assume that, under general principles of tax law, including the step transaction doctrine, *X*'s acquisition of the *Y* stock and the subsequent QSSS election would not be treated as related. The liquidation described in paragraph (a)(2) of this section occurs at the close of December 31, 1998, the day before the QSSS election is effective. The QSSS election for *Y* is effective on the same day that *X*'s S election is effective, and the deemed liquidation is treated as occurring before the S election is effective, when *X* is still a C corporation. *Y*'s taxable year ends at the close of December 31, 1998. See §1.381(b)–1.

Example 3. On June 1, 1998, *X*, an S corporation, acquires 100 percent of the stock of *Y*, an existing S corporation, for cash in a transaction meeting the requirements of a qualified stock purchase (QSP) under section 338. *X* immediately makes a QSSS election for *Y* effective June 2, 1998, and also makes a joint election under section 338(h)(10) with the shareholder of *Y*. Under section 338(a) and §1.338(h)(10)–1, *Y* is treated as having sold all of its assets at the close of the acquisition date, June 1, 1998. *Y* is treated as a new corporation which purchased all of those assets as of the beginning of June 2, 1998, the day after the acquisition date. Section 338(a)(2). The QSSS election is effective on June 2, 1998, and the liquidation under paragraph (a)(2) of this section occurs immediately after the deemed asset purchase by the new corporation.

Example 4. *X*, an S corporation, owns 100 percent of *Y*, a corporation for which a QSSS election is in effect. On May 12, 1998, a date on which the QSSS election is in effect, *X* issues *Y* a $10,000 note under state law that matures in ten years with a market rate of interest. *Y* is not treated as a separate corporation, and *X*'s issuance of the note to *Y* on May 12, 1998, is disregarded for federal tax purposes.

Example 5. *X*, an S corporation, owns 100 percent of the stock of *Y*, a C corporation. At a time when *Y* is indebted to *X* in an amount which exceeds the fair market value of *Y*'s assets, *X* makes a QSSS election effective on the date it is filed with respect to *Y*. The liquidation described in paragraph (a)(2) of this section does not qualify under sections 332 and 337 and, thus, *Y* recognizes gain or loss on the assets distributed, subject to the limitations of section 267.

§1.1361-5 Termination of QSSS election.

(a) *In general*—(1) *Effective date*. The termination of a QSSS election is effective —

(i) On the effective date contained in the revocation statement if a QSSS election is revoked under §1.1361–3(b);

(ii) At the close of the last day of the parent's last taxable year as an S corporation if the parent's S election terminates under §1.1362–2; or

(iii) At the close of the day on which an event (other than an event described in paragraph (a)(1)(ii) of this section) occurs that renders the subsidiary ineligible for QSSS status under section 1361(b)(3)(B).

(2) *Information to be provided upon termination of QSSS election by failure to qualify as a QSSS.* If a QSSS election terminates because an event renders the subsidiary ineligible for QSSS status, the S corporation must attach to its return for the taxable year in which the termination occurs a notification that a QSSS election has terminated, the date of the termination, and the names, addresses, and employer identification numbers of both the parent corporation and the QSSS.

(3) *Examples.* The following examples illustrate the application of this paragraph (a):

Example 1. Termination because parent's S election terminates. *X*, an S corporation, owns 100 percent of *Y*. A QSSS election is in effect with respect to *Y* for 1998. Effective on January 1, 1999, *X* revokes its S election. Because *X* is no longer an S corporation, *Y* no longer qualifies as a QSSS at the close of December 31, 1998.

Example 2. Termination due to transfer of QSSS stock. *X*, an S corporation, owns 100 percent of *Y*. A QSSS election is in effect with respect to *Y* for 1998. On December 10, 1998, *X* sells one share of *Y* stock to A, an individual. Because *X* no longer owns 100 percent of the stock of *Y*, *Y* no longer qualifies as a QSSS. Accordingly, the QSSS election made with respect to *Y* terminates at the close of December 10, 1998.

Example 3. No termination on stock transfer between QSSS and parent. *X*, an S corporation, owns 100 percent of the stock of *Y* and *Y* owns 100 percent of the stock of *Z*. QSSS elections are in effect with respect to both *Y* and *Z*. *Y* transfers all of its *Z* stock to *X*. Because *X* is treated as owning the stock of *Z* both before and after the transfer of stock solely for purposes of determining whether the requirements of section 1361(b)(3)(B)(i) and §1.1361–2(a)(1) have been satisfied, the transfer of *Z* stock does not terminate *Z*'s QSSS election. Because the stock of *Z* is disregarded for all other federal tax purposes, no gain is recognized under section 311.

(b) *Effect of termination of QSSS election*—(1) *Formation of new corporation.* If a QSSS election terminates under paragraph (a) of this section, the former QSSS is treated as a new corporation acquiring all of its assets (and assuming all of its liabilities) immediately before the termination from the S corporation parent in exchange for stock of the new corporation. The tax treatment of this transaction or of a larger transaction that includes this transaction will be determined under the Internal Revenue Code and general principles of tax law, including the step transaction doctrine.

(2) *Carryover of disallowed losses and deductions.* If a QSSS terminates because the S corporation distributes the QSSS stock to some or all of the S corporation's shareholders in a transaction to which section 368(a)(1)(D) applies by reason of section 355 (or so much of section 356 as relates to section 355), any loss or deduction disallowed under section 1366(d) with respect to a shareholder of the S corporation immediately before the distribution is allocated between the S corporation and the former QSSS with respect to the shareholder. The amount of the disallowed loss or deduction allocated to the S corporation is an amount that bears the same ratio to each item of disallowed loss or deduction as the value of the shareholder's stock in the S corporation bears to the total value of the shareholder's stock in both the S corporation and the former QSSS, in each case as determined immediately after the distribution.

(3) *Examples.* The following examples illustrate the application of this paragraph (b):

Example 1. *X*, an S corporation, owns 100 percent of the stock of *Y*, a corporation for which a QSSS election is in effect. *X* sells 21 percent of the *Y* stock to *Z*, an unrelated corporation, for cash, thereby terminating the QSSS election. *Y* is treated as a new corporation acquiring all of its assets (and assuming all of its liabilities) in exchange for *Y* stock immediately before the termination from the S corporation. The deemed exchange by *X* of assets for *Y* stock does not qualify under section 351 because *X* is not in control of *Y* within the meaning of section 368(c) immediately after the transfer as a result of the sale of stock to *Z*. Therefore, *X* must recognize gain, if any, on the assets transferred to *Y* in exchange for its stock. *X*'s losses, if any, on the assets transferred are subject to the limitations of section 267.

Example 2. Assume the same facts as in *Example 1*, except that, instead of purchasing *Y* stock, *Z* contributes to *Y* an operating asset in exchange for 21 percent of the *Y* stock. *Y* is treated as a new corporation acquiring all of its assets (and assuming all of its liabilities) in exchange for *Y* stock immediately before the termination. Because *X* and *Z* are cotransferors that control the transferee immediately after the transfer, the transaction qualifies under section 351.

Example 3. *X*, an S corporation, owns 100 percent of the stock of *Y*, a corporation for which a QSSS election is in effect. *X* distributes all of the *Y* stock pro rata to its shareholders, and the distribution terminates the QSSS election. The transaction can qualify as a distribution to which sections 368(a)(1)(D) and 355 apply if the transaction otherwise satisfies the requirements of those sections.

Example 4. *X*, an S corporation, owns 100 percent of the stock of *Y*, a corporation for which a QSSS election is in effect. *X* subsequently revokes the QSSS election. *Y* is treated as a new corporation acquiring all of its assets (and assuming all of its liabilities) immediately before the revocation from its S corporation parent in a deemed exchange for *Y* stock. On a subsequent date, *X* sells 21 percent of the stock of *Y* to *Z*, an unrelated corporation, for cash. Assume that under general principles of tax law including the step transaction doctrine, the sale is not taken into account in determining whether *X* is in control of *Y* immediately after the deemed exchange of assets for stock. The deemed exchange by *X* of assets for *Y* stock and the deemed assumption by *Y* of its liabilities qualify under section 351 because, for purposes of that section, *X* is in control of *Y* within the meaning of section 368(c) immediately after the transfer.

(c) *Inadvertent terminations.* Relief from the consequences of an inadvertent termination of a QSSS election may be available under the standards established by the Commissioner for the inadvertent termination of an S election under §1.1362–4.

(d) *Election after QSSS termination*—(1) *In general.* Absent the Commissioner's consent, and except as provided in paragraph (d)(2) of this section, a corporation whose QSSS election has terminated under paragraph (a) of this section (or a successor corporation as defined in

§1.1362–5(b)) may not make an S election under section 1362 or have a QSSS election under section 1361(b)(3)(B)(ii) made with respect to it for five taxable years (as described in section 1361(b)-(3)(D)). The Commissioner may permit an S election by the corporation or a new QSSS election with respect to the corporation before the 5-year period expires. The corporation requesting consent to make the election has the burden of establishing that, under the relevant facts and circumstances, the Commissioner should consent to a new election.

(2) *Exception.* If a corporation's QSSS election terminates by reason of a disposition of the corporation's stock, the corporation may, without requesting the Commissioner's consent, make an S election or have a QSSS election made with respect to it before the expiration of the five-year period described in section 1361(b)(3)(D) and paragraph (d)(1) of this section, provided that —

(i) Immediately following the disposition of its stock, the corporation (or its successor corporation) is otherwise eligible to make an S election or have a QSSS election made for it; and

(ii) The relevant election is made effective immediately following the disposition of the stock of the corporation.

(3) *Examples.* The following examples illustrate the application of this paragraph (d):

Example 1. Termination upon distribution of QSSS stock to shareholders of parent. X, an S corporation, owns *Y*, a QSSS. *X* distributes all of its *Y* stock to *X*'s shareholders. The distribution terminates the QSSS election because *Y* no longer satisfies the requirements of a QSSS. Assuming *Y* is otherwise eligible to be treated as an S corporation, *Y*'s shareholders may elect to treat *Y* as an S corporation effective on the date of the stock distribution without requesting the Commissioner's consent.

Example 2. Sale of 100 percent of QSSS stock. X, an S corporation, owns *Y*, a QSSS. *X* sells 100 percent of the stock of *Y* to *Z*, an unrelated S corporation. *Z* may elect to treat *Y* as a QSSS effective on the date of purchase without requesting the Commissioner's consent.

§1.1361–6 Effective date.

Except as provided in §1.1361–4(a)-(5)(i), the provisions of §§1.1361–2 through 1.1361–5 apply to taxable years beginning on or after the date that final regulations are published in the **Federal Register.**

Par. 5. Amend §1.1362–0 as follows:

1. Add an entry for §1.1362–2(b)(4).
2. Add entries for §1.1362–8.

The additions read as follows:

§1.1362–0 Table of contents.

* * * * *

§1.13622 Termination of election.

* * * * *

(b) * * *

(4) Termination when stock transferred to another S corporation.

* * * * *

§1.1362–8 Dividends received from affiliated subsidiaries.

(a) In general.
(b) Determination of active or passive earnings and profits.
(1) In general.
(2) Lower tier subsidiaries.
(3) *De minimis* exception.
(4) Special rules for earnings and profits accumulated by a C corporation prior to 80 percent acquisition.
(5) Gross receipts safe harbor.
(c) Allocating distributions to active or passive earnings and profits.
(1) Distributions from current earnings and profits.
(2) Distributions from accumulated earnings and profits.
(3) Adjustments to active earnings and profits.
(4) Special rules for consolidated groups.
(d) Examples.
(e) Effective date.

Par. 6. Amend §1.1362–2 as follows:

1. Amend paragraph (b)(1) by adding a sentence to the end of the paragraph.
2. Add paragraph (b)(4).
3. Amend paragraph (c)(5)(ii)(C) by adding a sentence to the end of the paragraph.

The additions read as follows:

§1.1362–2 Termination of election.

* * * * *

(b) * * *

(1) * * * See paragraph (b)(4) of this section for a special rule applying to the termination of an S election caused by the transfer of the corporation's stock to another S corporation.

* * * * *

(4) *Termination when stock transferred to another S corporation.* If all of the stock of an S corporation (S1) is transferred to another S corporation (S2) and a QSSS election for S1 is made effective as of the day of the transfer, S1's S election terminates at the same time as the deemed liquidation under §1.1361–4(a)(2). Accordingly, S1 is not treated as a C corporation for any period solely because of the transfer of S1 stock to S2, an ineligible S corporation shareholder. See, however, §1.338–1(e)(3) if an election under section 338 (without an election under section 338(h)(10)) is made. This paragraph (b)(4) is effective on the date final regulations are published in the **Federal Register.**

(c) * * *

(5) * * *

(ii) * * *

(C) * * * See §1.1362–8 for special rules regarding the treatment of dividends received by an S corporation from a C corporation in which the S corporation holds stock meeting the requirements of section 1504(a)(2).

* * * * *

Par. 7. Add §1.1362–8 to read as follows:

§1.1362–8 Dividends received from affiliated subsidiaries.

(a) *In general.* For purposes of section 1362(d)(3), if an S corporation holds stock in a C corporation meeting the requirements of section 1504(a)(2), the term "passive investment income" does not include dividends from the C corporation to the extent those dividends are attributable to the earnings and profits of the C corporation derived from the active conduct of a trade or business ("active earnings and profits"). For purposes of applying section 1362(d)(3), earnings and profits of a C corporation are active earnings and profits to the extent that the earnings and profits are derived from activities that would not produce passive investment income (as defined in section 1362(d)(3)) if the C corporation were an S corporation.

(b) *Determination of active or passive earnings and profits*—(1) *In general.* An S corporation may use any reasonable method to determine the amount of dividends that are not treated as passive in-

vestment income under section 1362(d)-(3)(E). Paragraph (b)(5) of this section describes a method of determining the amount of dividends that are not treated as passive investment income under section 1362(d)(3)(E) that is deemed to be reasonable under all circumstances.

(2) *Lower tier subsidiaries.* If a C corporation subsidiary (upper tier corporation) holds stock in another C corporation (lower tier subsidiary) meeting the requirements of section 1504(a)(2), the upper tier corporation's gross receipts attributable to a dividend from the lower tier subsidiary are considered to be derived from the active conduct of a trade or business to the extent the lower tier subsidiary's earnings and profits are attributable to the active conduct of a trade or business by the subsidiary under paragraph (b)(1), (b)(3), (b)(4), or (b)(5) of this section. For purposes of this section, distributions by the lower tier subsidiary will be considered attributable to active earnings and profits according to the rule in paragraph (c) of this section. This paragraph (b)(2) does not apply to any member of a consolidated group (as defined in §1.1502–1(h)).

(3) *De minimis exception.* If less than 10 percent of a C corporation's earnings and profits for a taxable year are derived from activities that would produce passive investment income if the C corporation were an S corporation, all earnings and profits produced by the corporation during that taxable year are considered active earnings and profits.

(4) *Special rules for earnings and profits accumulated by a C corporation prior to 80 percent acquisition.* A C corporation may treat all earnings and profits accumulated by the corporation in all taxable years ending before the S corporation held stock meeting the requirements of section 1504(a)(2) as active earnings and profits in the same proportion as the C corporation's active earnings and profits for the three taxable years ending prior to the time when the S corporation acquired 80 percent of the C corporation bears to the C corporation's total earnings and profits for those three taxable years.

(5) *Gross receipts safe harbor.* A corporation may treat its earnings and profits for a year as active earnings and profits in the same proportion as the corporation's gross receipts (as defined in §1.1362–2(c)(4)) derived from activities that would not produce passive investment income (if the C corporation were an S corporation), including those that do not produce passive investment income under paragraphs (b)(2) through (b)(4) of this section, bear to the corporation's total gross receipts for the year in which the earnings and profits are produced.

(c) *Allocating distributions to active or passive earnings and profits*—(1) *Distributions from current earnings and profits.* Dividends distributed by a C corporation from current earnings and profits are attributable to active earnings and profits in the same proportion as current active earnings and profits bear to total current earnings and profits of the C corporation.

(2) *Distributions from accumulated earnings and profits.* Dividends distributed by a C corporation out of accumulated earnings and profits for a taxable year are attributable to active earnings and profits in the same proportion as accumulated active earnings and profits for that taxable year bear to total accumulated earnings and profits for that taxable year immediately prior to the distribution.

(3) *Adjustments to active earnings and profits.* For purposes of applying paragraph (c)(1) or (c)(2) of this section to a distribution, the active earnings and profits of a corporation shall be reduced by the amount of any prior distribution properly treated as attributable to active earnings and profits from the same taxable year.

(4) *Special rules for consolidated groups.* For purposes of applying section 1362(d)(3) and this section to dividends received by an S corporation from the common parent of a consolidated group (as defined in §1.1502–1(h)), the following rules apply—

(i) The current earnings and profits, accumulated earnings and profits, and active earnings and profits of the common parent shall be determined under the principles of §1.1502–33 (relating to earnings and profits of any member of a consolidated group owning stock of another member); and

(ii) The gross receipts of the common parent shall be the sum of the gross receipts of each member of the consolidated group (including the common parent), adjusted to eliminate gross receipts from intercompany transactions (as defined in §1.1502-13(b)(1)(i)).

(d) *Examples.* The following examples illustrate the principles of this section:

Example 1. (i) *X*, an S corporation, owns 85 percent of the one class of stock of *Y*. On December 31, 1998, *Y* declares a dividend of $100 ($85 to *X*), which is equal to *Y*'s current earnings and profits. In 1998, *Y* has total gross receipts of $1,000, $200 of which would be passive investment income if *Y* were an S corporation.

(ii) One-fifth ($200/$1,000) of *Y*'s gross receipts for 1998 is attributable to activities that would produce passive investment income. Accordingly, one-fifth of the $100 of earnings and profits is passive, and $17 (1/5 of $85) of the dividend from *Y* to *X* is passive investment income.

Example 2. (i) The facts are the same as in *Example 1*, except that *Y* owns 90 percent of the stock of *Z*. *Y* and *Z* do not join in the filing of a consolidated return. In 1998, *Z* has gross receipts of $15,000, $12,000 of which are derived from activities that would produce passive investment income. On December 31, 1998, *Z* declares a dividend of $1,000 ($900 to Y) from current earnings and profits.

(ii) Four-fifths ($12,000/15,000) of the dividend from *Z* to *Y* are attributable to passive earnings and profits. Accordingly, $720 (4/5 of $900) of the dividend from *Z* to *Y* is considered gross receipts from an activity that would produce passive investment income. The $900 dividend to *Y* gives *Y* a total of $1,900 ($1,000 + $900) in gross receipts, $920 ($200 + $720) of which is attributable to passive investment income-producing activities. Under these facts, $41 ($920/1,900 of $85) of *Y*'s distribution to *X* is passive investment income to *X*.

(e) *Effective date.* This section applies to dividends received in taxable years beginning on or after the date that final regulations are published in the **Federal Register.**

§1.1368–0 [Amended]

Par. 8. Amend §1.1368–0 in the entry for §1.1368–2(d)(2) by revising "Reorganizations" to read "Liquidations and reorganizations".

§1.1368–2 [Amended]

Par. 9. Amend §1.1368–2 in paragraph (d)(2) by revising "Reorganizations" to read "Liquidations and reorganizations" in the heading and by revising "section 381(a)(2)" to read "section 381(a)" in the first sentence.

Par. 10. Amend §1.1374–8 by adding two sentences to the end of paragraph (b) to read as follows:

§1.1374–8 Section 1374(d)(8) transactions.

* * * * *

(b) *Separate determination of tax.* * * * If a C corporation elects to be treated as an S corporation, and also makes a QSSS election under section 1361(b)(3) (effective on the same date as the S election) with respect to a subsidiary, the assets held by the QSSS at the time of the QSSS election will be treated as assets held by the parent when it became an S corporation. The preceding sentence applies to QSSS elections made after the date final regulations are published in the **Federal Register.**

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Michael P. Dolan,
Deputy Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on April 21, 1998, 8:45 a.m., and published in the issue of the Federal Register for April 22, 1998, 63 F.R. 19864)

Change From Dollar Approximate Separate Transaction Method of Accounting (DASTM) to the Profit and Loss Method of Accounting/Change From the Profit and Loss Method to DASTM; Correction to T.D. 8765

Announcement 98–39

SUMMARY: This announcement contains corrections to final regulations (T.D. 8765 [1998–16 I.R.B. 11] 63 F.R. 10772), relating to adjustments required when a qualified business unit (QBU) that used the profit and loss method of accounting (P&L) in a post-1986 year begins to use the dollar approximate separate transaction method of accounting (DASTM) and adjustments required when a QBU that used DASTM begins using P&L.

DATES: This correction is effective April 6, 1998.

FOR FURTHER INFORMATION CONTACT: Howard Wiener of the Office of Chief Counsel (International), (202) 622-3870 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

The final regulations that are the subject of these corrections are under section 985 of the Internal Revenue Code.

Need for Correction

As published, the final regulations (T.D. 8765) contain errors which may prove to be misleading and are in need of clarification.

Correction of Publication

Accordingly, the publication of the final regulations (TD 8765), which was the subject of FR Doc. 98-5470, is corrected as follows:

§1.985–1 [Corrected]

1. On page 10774, column 2, §1.985–1 (b)(2)(ii)(C) is corrected as follows:

1. The paragraph heading for paragraph (b)(2)(ii)(C)(1) is added.

2. A new paragraph (b)(2)(ii)(C)(2) is added.

The corrections read as follows:

§1.985–1 Functional currency.

* * * * *

(b) * * *
(2) * * *
(ii) * * *
(C) * * * (*1*) *In general.* * * *

(2) *Effective date*. This paragraph (b)(2)(ii)(C) applies to taxable years beginning after April 6, 1998. However, a taxpayer may choose to apply this paragraph to all open years after December 31, 1986, provided each person, and each QBU branch of a person, that is related (within the meaning of §1.985–2(d)(3)) also applies to this paragraph (b)(2)(ii)(C).

§1.985–7 [Corrected]

2. On page 10775, column 2, §1.985–7 (b)(3), in the last three lines, the language "had translated its assets and liabilities under §1.985–3 during the look-back period." is corrected to read "had translated its assets and liabilities acquired and incurred during the look-back period under §1.985–3.".

4. On page 10776, column 2, §1.985–7 (c)(5), line 17, the language "of change.) For purposes of section 960," is corrected to read "of change). For purposes of section 960,".

5. On page 10776, column 2, §1.985–7 (c)(5), the last line, the language "section.)" is corrected to read "section).".

6. On page 10776, column 3, §1.985–7 (d)(5), the last two lines, the language "assets and liabilities under §1.985–3 during the look- back period." is corrected to read "assets and liabilities acquired and incurred during the look-back period under §1.985–3.".

Cynthia E. Grigsby,
Chief, Regulations Unit,
Assistant Chief Counsel (Corporate).

Allocation and Sourcing of Income and Deductions Among Taxpayers Engaged in a Global Dealing Operation; Correction

Announcement 98–40

SUMMARY: This announcement contains corrections, including a change to the date of the public hearing, to the notice of proposed rulemaking (REG–208299–90 [1998–16 I.R.B. 26] 63 F.R. 11177). The notice of proposed rulemaking relates to the allocation among controlled taxpayers and sourcing of income, deductions, gains and losses from a global dealing operation; rules applying these allocation and sourcing rules to foreign currency transactions and to foreign corporations engaged in a U.S. trade or business; and rules concerning the mark-to-market treatment resulting from hedging activities of a global dealing operation.

DATES: The public hearing originally scheduled for July 9, 1998 has been rescheduled for July 14, 1998.

ADDRESS: The public hearing will be held in room 2615, Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC 20224.

FOR FURTHER INFORMATION CONTACT: Ginny Chung, (202) 622-3870 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

The notice of proposed rulemaking that is subject to these corrections is under sections 482 and 864 of the Internal Revenue Code.

Need for Correction

As published, the notice of proposed rulemaking (REG–208299–90) contain errors that may prove to be misleading and are in need of clarification.

Correction of Publication

Accordingly, the publication of the notice of proposed rulemaking (REG–208299–90) which is the subject of F.R. Doc. 98–5674 is corrected as follows:

1. On page 11182, column 2, in the preamble under the heading "K. Source of Global Dealing Income", in the second paragraph, line 5, the language "§1.863–3 which sources income from a" is corrected to read "§1.863–3(h) which sources income from a".

2. On page 11185, column 2, in the preamble under the heading "Comments and Public Hearing", in the second paragraph, line 2, the language "for July 9, 1998, at 10 a.m. in room 2615," is corrected to read "for July 14, 1998, at 10 a.m. in room 2615,".

Cynthia E. Grigsby,
Chief, Regulations Unit,
Assistant Chief Counsel (Corporate).

Foundations Status of Certain Organizations

Announcement 98–41

The following organizations have failed to establish or have been unable to maintain their status as public charities or as operating foundations. Accordingly, grantors and contributors may not, after this date, rely on previous rulings or designations in the Cumulative List of Organizations (Publication 78), or on the presumption arising from the filing of notices under section 508(b) of the Code. This listing does *not* indicate that the organizations have lost their status as organizations described in section 501(c)(3), eligible to receive deductible contributions.

Former Public Charities. The following organizations (which have been treated as organizations that are not private foundations described in section 509(a) of the Code) are now classified as private foundations:

Paddock Bath and Tennis Club Inc., Florissant, MO
Painted Desert Demonstration Projects Inc., Flagstaff, AZ
Palo Pinto Humane Society Inc., Mineral Wells, TX
Panhandle Crimestoppers Inc., Guymon, OK
Panther Baseball Club Inc., Arlington, TX
Panther Soccer Booster Club Inc., Miami, FL
Paola Free Library Foundation, Paola, KS
Paramedic Relief Network, Maryland Hts, MO
Pard Athletic Club Inc., Marrero, LA
Parent Relative Organization for Oakwood Facilities Fund Inc., Covington, KY
Parent Support Network, Lansing, MI
Parenting Place, Southfield, MI
Parents Against Community Crime Organization Pacco Inc., Houston, TX
Parents and Kids Together Inc., Potomac, MD
Parents Empowered To Save Teens Inc., Mt. Pleasant, SC
Parents Re-Establishing Independent Development and Encouragement Pride, Phoenix, AZ
Parents Reaching Out, St. Charles, MO
Parents Who Care Inc., Tipp City, OH
Park Hill Literacy Inc., Denver, CO
Park Place Group Inc., Pinellas Park, FL
Parke-Vermillion Community Education & Employment Corporation, Clinton, IN
Parkway Pride Inc., Keslers Cross Lanes, WV
Partners in Education Inc., Poneto, IN
Partners in Education Inc., Roanoke, AL
Partners With Youth Foundation, Springfield, MO
Partnership Against Racism, Chicago, IL
Partnership for Families Inc., Greenville, SC
Pat Rush Ministries Inc., Titusville, FL
Pathfinders of Indiana Inc., Goshen, IN
Pathway Ministries Inc., Louisville, KY
Pathway of Light, Columbus, OH
Patidar Cultural Association of USA Inc., Stanhope, NJ
Patrick M. Gagliardi Foundation, Sault Ste Marie, MI
Paul Gage Ministries, Bedford, TX
Paul S. Morton Scholarship Foundation Inc., New Orleans, LA
Paulding County Genealogical Society, Paulding, OH
Payson Choral Society, Payson, AZ
Peace and Joy Ministries Inc., Haysville, KS
Peaceful Dove Enterprises Incorporated, Palm Bay, FL
Peaceful Valley Ranch, Westminster, CO
Pediatric Assistance International Inc., Ann Arbor, MI
Pee Dee Electric Trust, Darlington, SC
Pegasus Incorporated of South Carolina, Blacksburg, SC
Pennsylvania Elk Foundation, Reading, PA
Pennsylvania Quality Leadership Foundation Inc., Harrisburg, PA
Pennsylvania Religious Coalition for Abortion Rights, Philadelphia, PA
Penumbra U S A Inc., Shaker Hts, OH
People Against Cigarette Smoke PACS Inc., Destreham, LA
People First of Illinois, Wayne, IL
People Help People Face to Face Inc., Evanston, IL
People Helping People-Disaster Relief Inc., Teaneck, NJ
People Organized for Excellence in Education, Beaumont, TX
Peoples Community Hope for Homes Inc., Westland, MI
Performing Artists Network Inc., Linwood, NJ
Performing Arts League Inc., Cleveland, OH
Petoskey Youth Soccer Association, Petoskey, MI
Petra Ministries Inc., Glendale, AZ
Pets for the Elderly Foundation, Cleveland, OH
PFLAG Suburban Chicago—Parents Families and Friends of Lesbians and Gays Inc., Downers Grove, IL
Phase I Colorguard, St. Louis, MO
Phenix City Education Foundation Inc., Phenix City, AL
PHFD Womens Association, Prospect Heights, IL
Philadelphia Korean War Veterans Memorial Inc., Philadelphia, PA
Philadelphia Student Athletes Inc., Parkesburg, PA

Philip Simmons Foundation Inc., Charleston, SC
Philippine Development Forum, Washington, DC
Phineas Newborn Jr. Fam Foundation, Memphis, TN
PHS Community Development Corporation, Detroit, MI
Pictorial Research LTD Inc., West Des Moines, IA
PIN—People in Need, Gowen, MI
Pinellas Pioneer Settlement Inc., St. Petersburg, FL
Pioneer Artists Inc., Dodge City, KS
Pioneer Historical Museum & Interpretive Center, Ft. Laramie, WY
Pipestone Performing Arts Center Inc., Pipestone, MN
Pitre Vision Home, Dallas, TX
Pitt County Helping Hands Inc., Greenville, NC
Pitt-Greenville Opportunities Industrialization Center Inc., Greenville, NC
Pittsburgh Ensemble Theatre Company, Pittsburgh, PA
Pittsburgh Young Professionals Inc., Pittsburgh, PA
Plaisance Mortagage Corporation, Opelousas, LA
Plano Housing Corporation, Plano, TX
Plants for Clean Air Council Inc., Mitchellville, MD
Plateau Youth Center, Olathe, CO
Pleasant Hill Child Enrichment Center, Pleasant Hill, TN
Pleasant Prairie Professional Police Association, Pleasant, WI
Poinciana Youth Baseball, Poinciana, FL
Poindexter Ministries Inc., Washington, DC
Point Pleasant Community Association Inc., Point Pleasant, PA
Police Athletic League of Port Orange Inc., Port Orange, FL
Police Benevolent Fund Inc., Atlanta, GA
Porter County Champs Inc., Valparaiso, IN
Portsmouth Inner City Development Corporation Housing Association II, Portsmouth, OH
Positive Approach Inc., Victoria, TX
Positive Changes Incorporated, Lewisburg, PA
Positive Direction for Youth Inc., Greensboro, NC
Positive People Inc., Chicago, IL
Positive Support Institute, Trenton, MI
Possibilities Productions Unlimited, Denver, CO
Postal Employees-John Miller Scholarship Fund, Roseville, MN
Pottawatomie Indian Museum Polyak Foundation Inc., Beverly Shores, IN
Power Connection Ministries Inc., Kingwood, TX
Power of Praise Ministries Inc., Cleveland, SC
Power Partenting Association Inc., Ellicott City, MD
Practical Christian Services Inc., Concord, NC
Prairie Dance Theatre, Clinton, IL
Praying Tobacco Charitable Organization, Wakpala, SD
Preble County Dare Inc., New Paris, OH
Precinct 2 Mounted Patrol of Harris County, Houston, TX
Pregnancy Care Center of Fairfield County Inc., Lancaster, OH
Premiere Musical Theater Warehouse, Denver, CO
Prep Alumni II, Waukegan, IL
Prespress Publishing of Michigan, Kalamazoo, MI
Presby Tips Foundation, Cairo, IL
Presbyterian Coalition for Loving Justice, Washington, DC
Preserve the Schuyler Colfax House, Wayne, NJ
Press Club of Houston, Houston, TX
Press Club of Houston Educational Foundation Inc., Houston, TX
Preventive Aging Center Inc., South Amboy, NJ
Pride of Tennessee Education Foundation, Nashville, TN
Primary Resource Developers Group Inc., Norcross, GA
Prince Frederick Foundation, Raleigh, NC
Prince Hall Foundation Inc., North Brunswick, NJ
Prisoners Against Crime, Lakewood, CO
Proclaim Ministries Inc., Rockford, IL
Professional Training Institute Inc., Silver Spring, MD
Professionals for Houstons Homeless, Spring, TX
Professions of Edgewood, San Antonio, TX
Program of Emmanuels Hands, Allentown, PA
Progress for Youth Inc., Mountain Home, AR
Progressive Foundation for Social Responsibility, Eden Prairie, MN
Project D A R E Drug Abuse Resistance Education for Maury Co., Columbia, TN
Project Help Inc., Sweetwater, TN
Project Independence Incorporated of Sedgwick County, Wichita, KS
Project Intercept, Denver, CO
Project Jericho, New Orleans, LA
Project Kids Inc., Allen, TX
Project Match Incorporated, Smyrna, GA
Project Me Inc., Tucson, AZ
Project New Smile, Baltimore, MD
Project Playground—Central Park, Beaumont, TX
Project Reach Out Incorporated Pro Inc., Indianapolis, IN
Project-Rescue Band, Sheffield Lake, OH
Project Safe House Inc., Atlanta, GA
Project Second Chance Inc., Cleveland, OH
Project Self-Help, Beaumont, TX
Project Victory Inc., Pompano Beach, FL
Promise Land Community Shelter, Detroit, MI
Promises People Reaching Out Ministering in Spiritual Emotional Support Inc., Longmont, CO
Promoting African American Success in Schools, Fort Worth, TX
Promoting Animal Welfare Society Inc., Muskogee, OK
Prophetic Insights Inc., Fletcher, NC
Prospect Plains Housing Corporation, Monmouth Junction, NJ
Providers of Encouragement and Assistance To Restructure Your Life, Houston, TX
Providing for the Needy Inc., Louisville, KY
Psychiatrists for Better Psychiatry Inc., Louisville, KY
Public Service Telecommunications Corporation International, Arlington, VA
Puebloans Against Violent Environment, Pueblo, CO
Puerto Rico Society of Cleveland, Lakewood, OH
Pulliam Ministries Inc., Tulsa, OK
Purr-Fect Haven Inc., San Antonio, TX
Pushkin Goncharov Historical Foundation, Greenwood Village, CO
Quad Cities Womens Encouragement Board Inc., Bettendorf, IA
Quality Nutrition for Kids, Houston, TX

Queen Annes County Watermans Festivals, Inc., Queenstown, MD

Quilt Guild of Greater Victoria Inc., Victoria, TX

If an organization listed above submits information that warrants the renewal of its classification as a public charity or as a private operating foundation, the Internal Revenue Service will issue a ruling or determination letter with the revised classification as to foundation status. Grantors and contributors may thereafter rely upon such ruling or determination letter as provided in section 1.509(a)–7 of the Income Tax Regulations. It is not the practice of the Service to announce such revised classification of foundation status in the Internal Revenue Bulletin.

Announcement of the Consent Voluntary Suspension of Attorneys, Certified Public Accountants, Enrolled Agents, and Enrolled Actuaries From Practice Before the Internal Revenue Service

Under 31 Code of Federal Regulations, Part 10, an attorney, certified public accountant, enrolled agent, or enrolled actuary, in order to avoid the institution or conclusion of a proceeding for his disbarment or suspension from practice before the Internal Revenue Service, may offer his consent to suspension from such practice. The Director of Practice, in his discretion, may suspend an attorney, certified public accountant, enrolled agent, or enrolled actuary in accordance with the consent offered.

Attorneys, certified public accountants, enrolled agents, and enrolled actuaries are prohibited in any Internal Revenue Service matter from directly or indirectly employing, accepting assistance from, being employed by, or sharing fees with any practitioner disbarred or suspended from practice before the Internal Revenue Service.

To enable attorneys, certified public accountants, enrolled agents, and enrolled actuaries to identify practitioners under consent suspension from practice before the Internal Revenue Service, the Director of Practice will announce in the Internal Revenue Bulletin the names and addresses of practitioners who have been suspended from such practice, their designation as attorney, certified public accountant, enrolled agent, or enrolled actuary, and date or period of suspension. This announcement will appear in the weekly Bulletin at the earliest practicable date after such action and will continue to appear in the weekly Bulletins for five successive weeks or for as many weeks as is practicable for each attorney, certified public accountant, enrolled agent, or enrolled actuary so suspended and will be consolidated and published in the Cumulative Bulletin.

The following individuals have been placed under consent suspension from practice before the Internal Revenue Service:

Name	Address	Designation	Date of Suspension
Soulides, James C.	Berwyn, IL	CPA	January 1, 1998 to June 30, 2000
Bujan, Frank	Orland Park, IL	CPA	January 1, 1998 to June 30, 2000
Field, Edward L.	Topeka, KS	CPA	January 27, 1998 to April 26, 1999
Cito, Paul J.	West Orange, NJ	CPA	February 21, 1998 to May 20, 1999
Sproul, Jerry	Idaho Falls, ID	CPA	February 25, 1998 to October 24, 1998
Hunt, Russell	Pauls Valley, OK	CPA	March 1, 1998 to June 30, 1998
Oertli, William	Rochester, MN	CPA	Mach 4, 1998 to March 3, 2000
Maynard, Richard	Reno, NV	CPA	March 10, 1998 to March 9, 2002
McDonald, Bill	Reno, NV	Attorney	March 10, 1998 to March 9, 2002
Komendant, Howard	Passaic, NJ	CPA	March 10, 1998 to September 9, 1998
Kwiatek, Fabian A.	Silver Spring, MD	CPA	March 16, 1998 to March 15, 2001
Brown, Patricia	DeKalb, IL	CPA	March 16, 1998 to September 15, 1999
Marshall, Robert	Woodland Hills, CA	Attorney	March 18, 1998 to November 17, 2000
Baloun, Donald J.	Palatine, IL	CPA	March 25, 1998 to November 24, 1998
Goldman, Harold J.	Summit, NJ	CPA	March 27 , 1998 to September 26, 1998
Garner, Darrow C.	Austin, TX	CPA	April 1, 1998 to March 30, 2000
Klein, Charles U.	Dunedin, FL	CPA	April 1, 1998 to September 30, 1999
Morgan, Robert I.	Brownsville, VT	Attorney	April 2, 1998 to April 1, 2000
Teel, Jeffrey J.	Hollis, NH	CPA	April 2, 1998 to April 1, 2001
Hancock, Randall M.	Gardendale, AL	CPA	Indefinite from April 13, 1998
Allison Jr., Dale A.	Blairsville, GA	Attorney	April 15, 1998 to July 14, 2001
Gogel, William A.	North Hills, NY	Attorney	April 21, 1998 to April 20, 2002
Bose, Gautem	Oak Brook, IL	CPA	May 1, 1998 to April 30, 2001
Woods, W. Rex	Belleville, KS	CPA	May 1, 1998 to January 31, 1999
Monahan, John	Seattle, WA	Attorney	May 1, 1998 to April 30, 2001
Swartz, Lewis A.	Syosset, NY	CPA	May 1, 1998 to April 30, 2002

Name	Address	Designation	Date of Suspension
Eckert, Bruce G.	Cleveland, OH	CPA	May 2, 1998 to May 1, 1999
Rozanski, Lawrence J.	Pittsburgh, PA	CPA	June 1, 1998 to May 30, 2000
Mangum, Carl E.	Morris Plains, NJ	CPA	July 1, 1998 to December 31, 1999
Reeser, Richard M.	Thornton, CO	CPA	July 1, 1998 to September 30, 1999
Bailey, Thomas O.	Dallas, TX	CPA	July 1, 1998 to June 30, 2001
Johnson, Kenneth E.	Forest Lake, MN	CPA	July 1, 1998 to November 30, 1999
Deren, Joseph	Lackawanna, NY	Attorney	July 1, 1998 to June 30, 2001

Definition of Terms

Revenue rulings and revenue procedures (hereinafter referred to as "rulings") that have an effect on previous rulings use the following defined terms to describe the effect:

Amplified describes a situation where no change is being made in a prior published position, but the prior position is being extended to apply to a variation of the fact situation set forth therein. Thus, if an earlier ruling held that a principle applied to A, and the new ruling holds that the same principle also applies to B, the earlier ruling is amplified. (Compare with *modified*, below).

Clarified is used in those instances where the language in a prior ruling is being made clear because the language has caused, or may cause, some confusion. It is not used where a position in a prior ruling is being changed.

Distinguished describes a situation where a ruling mentions a previously published ruling and points out an essential difference between them.

Modified is used where the substance of a previously published position is being changed. Thus, if a prior ruling held that a principle applied to A but not to B, and the new ruling holds that it applies to both A and B, the prior ruling is modified because it corrects a published position. (Compare with *amplified* and *clarified*, above).

Obsoleted describes a previously published ruling that is not considered determinative with respect to future transactions. This term is most commonly used in a ruling that lists previously published rulings that are obsoleted because of changes in law or regulations. A ruling may also be obsoleted because the substance has been included in regulations subsequently adopted.

Revoked describes situations where the position in the previously published ruling is not correct and the correct position is being stated in the new ruling.

Superseded describes a situation where the new ruling does nothing more than restate the substance and situation of a previously published ruling (or rulings). Thus, the term is used to republish under the 1986 Code and regulations the same position published under the 1939 Code and regulations. The term is also used when it is desired to republish in a single ruling a series of situations, names, etc., that were previously published over a period of time in separate rulings. If the new ruling does more than restate the substance of a prior ruling, a combination of terms is used. For example, *modified* and *superseded* describes a situation where the substance of a previously published ruling is being changed in part and is continued without change in part and it is desired to restate the valid portion of the previously published ruling in a new ruling that is self contained. In this case the previously published ruling is first modified and then, as modified, is superseded.

Supplemented is used in situations in which a list, such as a list of the names of countries, is published in a ruling and that list is expanded by adding further names in subsequent rulings. After the original ruling has been supplemented several times, a new ruling may be published that includes the list in the original ruling and the additions, and supersedes all prior rulings in the series.

Suspended is used in rare situations to show that the previous published rulings will not be applied pending some future action such as the issuance of new or amended regulations, the outcome of cases in litigation, or the outcome of a Service study.

Abbreviations

The following abbreviations in current use and formerly used will appear in material published in the Bulletin.

A—Individual.
Acq.—Acquiescence.
B—Individual.
BE—Beneficiary.
BK—Bank.
B.T.A.—Board of Tax Appeals.
C.—Individual.
C.B.—Cumulative Bulletin.
CFR—Code of Federal Regulations.
CI—City.
COOP—Cooperative.
Ct.D.—Court Decision.
CY—County.
D—Decedent.
DC—Dummy Corporation.
DE—Donee.
Del. Order—Delegation Order.
DISC—Domestic International Sales Corporation.
DR—Donor.
E—Estate.
EE—Employee.
E.O.—Executive Order.
ER—Employer.
ERISA—Employee Retirement Income Security Act.
EX—Executor.
F—Fiduciary.
FC—Foreign Country.
FICA—Federal Insurance Contribution Act.
FISC—Foreign International Sales Company.
FPH—Foreign Personal Holding Company.
F.R.—Federal Register.
FUTA—Federal Unemployment Tax Act.
FX—Foreign Corporation.
G.C.M.—Chief Counsel's Memorandum.
GE—Grantee.
GP—General Partner.
GR—Grantor.
IC—Insurance Company.
I.R.B.—Internal Revenue Bulletin.
LE—Lessee.
LP—Limited Partner.
LR—Lessor.
M—Minor.
Nonacq.—Nonacquiescence.
O—Organization.
P—Parent Corporation.
PHC—Personal Holding Company.
PO—Possession of the U.S.
PR—Partner.
PRS—Partnership.
PTE—Prohibited Transaction Exemption.
Pub. L.—Public Law.
REIT—Real Estate Investment Trust.
Rev. Proc.—Revenue Procedure.
Rev. Rul.—Revenue Ruling.
S—Subsidiary.
S.P.R.—Statements of Procedral Rules.
Stat.—Statutes at Large.
T—Target Corporation.
T.C.—Tax Court.
T.D.—Treasury Decision.
TFE—Transferee.
TFR—Transferor.
T.I.R.—Technical Information Release.
TP—Taxpayer.
TR—Trust.
TT—Trustee.
U.S.C.—United States Code.
X—Corporation.
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Z—Corporation.

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[1] A cumulative list of all revenue rulings, revenue procedures, Treasury decisions, etc., published in Internal Revenue Bulletins 1997–27 through 1997–52 will be found in Internal Revenue Bulletin 1998–1, dated January 5, 1998.

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